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IN THE

Supreme Court of the United States

October Term, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
Petitioner,

vs.

THE STATE OF NEW JERSEY.

BRIEF FOR PETITIONER

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BRIEF FOR PETITIONER

I

Opinions Below

The opinion of the Circuit Court of Appeals for the Third Circuit is reported in 152 Fed. (2d) 408. It is printed in the Record (p. 148). The opinion of the District Court of the United States for the District of New Jersey confirming the Special Master's Interim Report (R. 27), which was reversed by the Circuit Court of Appeals, is not officially reported but appears in the Record (p. 40).

II

Jurisdiction

The jurisdiction of this court is invoked under the Act of February 13, 1925, C. 229, Sec. 1, 43 Stat. 938; USCA Tit. 28, Sec. 347.

The date of the judgment of the Circuit Court of Appeals which reversed Order No. 271 in the matter of The Central Railroad Company of New Jersey reorganization proceedings was November 15, 1945 (R. 168).

The order of this court allowing certiorari was filed June 10, 1946 (R. 147).

III

Statement of the Case

A. Introductory Statement

Petitioner is the surviving trustee of The Central Railroad Company of New Jersey, an interstate railroad which is in reorganization in the District Court of the United States for the District of New Jersey under Section 77 of the Bankruptcy Act.* Debtor's petition for reorganization was filed on October 30, 1939. At that time the State of New Jersey claimed balances of taxes for each of seven years aggregating $11,651,081.86 and additional taxes were claimed to be payable December 1, 1939 in the sum of $3,415,922.05 (R. 192).

The State now claims that interest penalties of one percent. per month have been accruing on the taxes in arrears from the date they originally became due and

---

* Petitioner's co-trustee, Shelton Pitney, Esq., died January 13, 1946.

payable. Although the trustee on court order has made payments on account out of the general assets of the debtor in excess of $18,000,000, the State now contends that there is in excess of $15,000,000 still due it.

This case arises from a petition of the trustees to the District Court (R. 43), filed on August 14, 1944, to determine the following essential questions that arose in the proceedings:

(1) Whether a compromise of the claim for taxes had been entered into between the State of New Jersey and the trustees, under and in strict compliance with Railroad Tax Settlement Acts passed by the State, under which, before the constitutionality of said Acts was determined, the trustees on court order had accepted the offer of settlement therein contained; had discontinued all pending appeals from taxes; and had made payments of other disputed taxes without contest; after all of which it was impossible to have the *status quo ante* reinstated.

(2) Whether, if no such settlement by compromise had been effected, to what extent the claim of the State against the debtor for principal amount of taxes and for interest penalties should be allowed in the bankruptcy proceedings; and

(3) What are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate.

Upon the filing of said petition the Attorney General of New Jersey, although he had previously appeared generally in the proceedings, filed a special appearance (R. 78) and contended that the Bankruptcy Court was without jurisdiction to make the determination of the matters aforesaid, on the ground that the petition of the trustees constituted a suit against the State without its consent. The District Court thereupon referred the matter to a Special

Master (R. 80), who filed an Interim Report (R. 27) holding that the entire property of the railroad is *in custodia legis*, and that the Bankruptcy Court is the proper court to determine the validity and amount of the tax claims of the State and incidental liens and that the Trustees' petition for adjudication of liens should not be dismissed.

Objections were made by the State to this report (R. 129), and the District Court after a hearing made Order No. 271 (R. 138) confirming the Interim Report of the Special Master. The Attorney General appealed from this order (R. 141). Before the case was heard in the Circuit Court of Appeals the Attorney General of the State filed in the Circuit Court of Appeals a petition for writ of prohibition (R. 10) praying that the Circuit Court of Appeals forbid the District Court and Special Master from making any adjudication in connection with the tax debt liens of the State.

The Circuit Court of Appeals in its opinion (R. 148) denied the petition for a writ of prohibition and in reversing Order No. 271 of the District Court said:

> "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. • • •
>
> "In No. 8889 Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition in No. 8861 is therefore dismissed, without costs to either party as against the other."

This, when read with the judgment reversing Order No. 271, was an instruction that the amount of the State's claim for taxes and penalties and the lien asserted were no longer open to further litigation.

The trustee filed a petition for rehearing (R. 170) asserting that the court had misconceived the questions involved on the appeal and had determined the matter as though only the assessments were involved, whereas the

question actually involved was solely as to *the jurisdiction of the Bankruptcy Court over the claims of the State of New Jersey for taxes and interest and penalties and all matters in relation thereto.* The trustees had waived all questions as to the assessments of such taxes. The petition for rehearing was denied (R. 186) and this court granted certiorari.

It seems important to define the status of the State's claims for taxes and interest (a) at the commencement of the reorganization proceedings, (b) their treatment during the reorganization proceedings, and (c) their present status.

Although, as will appear below, the State formally filed its claims in the reorganization proceeding (R. 64) and prayed for their allowance "in the order of priority specified in Sec. 64 11 U. S. C. A. 104 of the Bankruptcy Law", the position of the present Attorney General is that these claims being represented "by liens that were fixed prior to bankruptcy", are outside the jurisdiction of the Bankruptcy Court.

B. Status of the State's Claims on October 30, 1939

When debtor's petition for reorganization was filed on October 30, 1939, the status of the claims of the State for taxes for the years 1932 to 1939, inclusive, was as follows:

1932 and 1933 Assessments, Taxes and Interest

The 1932 and 1933 assessments had been reviewed on appeal and sustained by the State Board of Tax Appeals, whose judgment in the 1933 case had been reviewed and affirmed by the State Supreme Court. Bills in equity were filed in the United States District Court to set aside the assessments for 1932 and 1933 on the ground of unjust discrimination, in which the debtor was unsuccessful. (See detailed statement annexed to State's claim (R. 70).)

After all this litigation was determined in favor of the State, its Attorney General gave notice on October 20,

1939 that, pursuant to N. J. R. S. 54:28-1 et seq. he would, on November 2, 1939, apply to the New Jersey Supreme Court for the entry of a summary judgment for unpaid taxes for the years 1932 and 1933 amounting to $3,979,185, plus penalties* to November 2, 1939 amounting to $3,250,429, or a total of $7,229,614, and for the appointment of a Master to sell debtor's property under said judgment. This notice, in view of the debtor's inability to make the payments demanded, was the immediate cause of the filing of debtor's petition for reorganization on October 30, 1939 (R. 192). The trustees and bondholders filed objections to the State's claims for these taxes in the Bankruptcy Court, alleging among others various constitutional grounds (R. 73, 74, Pars. I and J).

1934, 1935 and 1936 Assessments, Taxes and Interest

The 1934, 1935 and 1936 assessments of taxes against the debtor had been reviewed on appeal to and sustained by the State Board of Tax Appeals.

After exhausting their administrative remedy in the State Tribunals debtor and a number of other railroads secured injunctions in the United States District Court pendente lite restraining the collection of said taxes. After an exhaustive trial Judge Forman in *Central Railroad of New Jersey* v. *Martin*, 30 Fed. Supp. 41, filed his opinion on November 1, 1939, two days after the debtor filed its petition for reorganization, holding that said taxes and similar taxes of numerous other railroads had been assessed "in plain violation of established principles that govern property valuation", and that "the prayers of the plaintiffs for injunctions to restrain the collection of taxes will be granted until such time as the taxing authorities of New Jersey revalue the property in accordance with the

* of 1% per month, R. S. 54:27-4. The law of the Third Circuit at that time was that this was a penalty, and not allowable under Sec. 57 J. *In re Pressed Steel Car Co.*, 100 F. 2d, 147.

views herein expressed". Subsequently, a decree was entered restraining the collection of more than 70% of the taxes assessed.

On an appeal by the State, in which the State failed and neglected to join the trustees as parties respondent, the Circuit Court of Appeals for the Third Circuit, on November 27, 1940, reversed the District Court (*Central Railroad et al.* v. *Martin,* 115 Fed. (2d) 968; cert. den. 313 U. S. 568). (See, also statement annexed to State's Claim R. 70.)

1937, 1938 and 1939 Assessments, Taxes and Interest

When the debtor filed its petition for reorganization it had appeals pending before the State Board of Tax Appeals from assessments for the years 1937, 1938 and 1939. The Board did not file its decision affirming the taxes for 1937 and 1938 until May 13, 1941 (*Central Railroad Company of New Jersey Appeal,* 19 N. J. Misc. 427). Under the provisions of the New Jersey Statute, R. S. 54:29a-36 debtor had until August 13, 1941 (90 days) to apply to the New Jersey Supreme Court for a writ of certiorari to review said decision. On August 11, 1941 the trustees waived this right as a condition of accepting the offer of compromise contained in the Tax Settlement Act hereinafter referred to.

Debtor's appeal from the taxes assessed in 1939 was duly taken but had not been acted upon when the trustees, with court approval, discontinued the appeal and accepted the provisions of the Tax Settlement Act as hereafter mentioned. (See Statement annexed to State's Claim for Taxes, R. 71.)

Accordingly, when debtor's petition for reorganization was filed, the amount of its liability for taxes and interest for each of the years 1932 to 1939, inclusive, was in issue and being litigated either before the State Board of Tax

Appeals or in the Federal Courts, and that the amount of the State's liens for each of said tax years was wholly unsettled.

C. Proceedings on the State's Claim for Taxes and Interest Penalties in the Reorganization Proceedings

Two days after the filing of the petition for reorganization the District Court, on November 1, 1939, entered an order restraining the Attorney General from continuing the proceedings that he had started for the entry of judgment in the New Jersey Supreme Court for taxes levied against the debtor by the State for the years 1932 and 1933 and for interest thereon (R. 195).

On December 7, 1939 the debtor filed a petition with the court for instructions whether it should prosecute its appeal before the State Board of Tax Appeals from the 1939 tax assessment and whether pending the filing and allowance of claims by creditors it should make a payment on account of 1939 taxes. An affidavit of the Comptroller of the debtor filed with the court and verified December 12, 1939, showed that the total tax claims of the State for the years 1932 to 1939, inclusive, not including penalties or interest, aggregated $15,067,002 (R. 200), while the total estimated liquid resources of the railroad were $7,097,458, or, about $8,000,000 less than the principal amount of the taxes, not including penalties or interest (R. 199).

On the debtor's petition aforesaid Judge Fake issued an order requiring the Attorney General of the State and all others in interest to show cause why an order should not be entered instructing the debtor whether it should pay any part of the 1939 taxes (R. 201). In response to this order to show cause Mr. Solan, Assistant to the

Attorney General of the State, appeared in court on December 13, 1939 (R. 202) and asked the court to make "an order that the debtor pay out of the funds in hand • • • at least sixty percentum of the taxes levied against the property for the year 1939" (R. 206).

On December 26, 1939 an order was made directing the debtor to pay to the State $2,049,553.23 on account of the taxes claimed to be assessed against its property by the State for 1939 (R. 220). This amount (60%) was paid out of the general funds of the debtor in the hands of the trustees to which the State's alleged lien did not apply.

On June 12, 1940 the trustees filed a petition for an order authorizing them to pay out of the funds of the debtor $100,000 per month on account of the State's taxes for 1932 and 1933 (R. 222). The Attorney General, Mr. Wilentz, appeared in court on the filing of this petition and asked the court to make an order for more substantial payments than $100,000 per month if the debtor was financially able (R. 227). The following day Judge Walker signed an order authorizing the trustees to pay to the State six monthly instalments of $150,000 each beginning July 1, 1940, on account of the taxes for the years 1932 and 1933 (R. 230). These payments likewise were made out of the general assets in the hands of the trustees.

On November 25, 1940 the trustees filed a petition for instructions as to what part of the taxes assessed against the debtor and subsidiaries for the year 1940 they should pay (R. 236). The Attorney General filed an answer to this petition praying "that the trustees of the debtor be directed to pay immediately to the Treasurer of the State of New Jersey • • • the full amount of the taxes levied for 1940" (R. 238). After hearing, the reorganization court directed that $2,030,742.78 be paid to the State on account of taxes assessed for the year 1940 (R. 240). This was 60% of the taxes assessed for 1940.

As required by Section 77(c)(7) of the Bankruptcy Act, 11 U. S. C. A. (c) (7) the Bankruptcy Court on pe-

tition of the trustees made an order on October 7, 1940 requiring claims of all creditors of the debtor to be filed on or before December 31, 1940 (R. 232). In compliance with this order the State of New Jersey as claimant, by its Comptroller, a constitutional officer, on December 15, 1940 filed its proof of claim demanding payment of the *full balance of taxes and interest at 12% per annum* claimed to be due by the State from the debtor for the years 1932 to 1939, inclusive (R. 64). The total amount of claim was stated to be:

> "$12,117,450.68 taxes, plus interest thereon in the sum of $7,732,339.53, plus additional interest on said unpaid taxes from December 1, 1940 to date of payment" (R. 64).

Partial payments theretofore made were stated as aggregating $18,128,962.82, as shown in detail on Schedules A and B attached (R. 65). The schedules appear on pages 68 and 69 and list the first-class and second-class railroad taxes year by year, with the payments made on account in each year, and the taxes due with interest at 1% per month to December 1, 1940.

This proof of claim was in the form required by Section 57, 11 U. S. C. A. 93 of the Bankruptcy Act, and paragraph 10 reads as follows:

> "(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:
>
> "The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The

lien shall take effect on June 1 of the year in which the tax is payable."

While the present Attorney General now asserts that this proof of claim amounted merely to a notice that "the State had liens for taxes that were outside the jurisdiction of the court, and to lay the basis for the making by the Comptroller of a claim on behalf of the State for any deficit that might arise in the event that the property of the debtor should not be sufficient to satisfy the tax lien", the claim was not "for any deficit that might arise" but was expressly for "unpaid balances of taxes assessed and levied by the State of New Jersey upon property and franchises of the debtor for the years 1932 to 1939, both inclusive" plus interest of 1% per month (R. 64).

In view of the State's present contention that all questions as to the amount and legality of taxes were *res judicata* when the reorganization proceeding began, and that the formal filing of the proof of claim did not in fact invoke the jurisdiction of the Bankruptcy Court but was merely a notice of a perfected lien, it is of interest to note that on December 15, 1940, when the proof of claim demanding payment aforesaid was filed, the law of the Circuit Court was that the 12% interest claimed by the State amounted to a penalty and was not allowable under Section 57(j) 11 U. S. C. A. 93(j) of the Bankruptcy Act. (See footnote, p. 6, *supra*.)

It is further interesting to note that at the time the claim was filed the decision of the District Court restraining the collection of more than 70% of the principal amount of taxes assessed for the years 1934, 1935 and 1936 was still pending on appeal before the Third Circuit (see 115 Fed. (2d) 968, rehearing denied Jan. 24, 1941). Furthermore appeals from the taxes assessed for the years 1937, 1938, 1939 and 1940 were still pending before the State Board of Tax Appeals.

The trustees filed detailed objections to the allowance of the State's proof of claim on February 27, 1941 (R. 71), contending, among other things, that the property of the debtor was grossly overvalued; that each structure was valued independently at cost, less depreciation, and in complete disregard of its market value or true value* as part of an operating railroad property; that the real and personal property of the debtor and other railroads was assessed in excess of true value while other real property in the State was intentionally and systematically assessed at not more than 60% of value, and personal property of taxpayers other than railroads was systematically and intentionally omitted from taxation, and when taxed was assessed at less than half the ascertainable value (R. 71). Detailed objections were also filed as to the allowance of 1% interest per month as claimed (R. 76).

On March 26, 1941 the State, by its former Attorney General, filed in the Bankruptcy Court a "Reply of Claimant State of New Jersey to Trustees' Objections to Tax Claims" (R. 242), which, after denying the allegations in the State's objections, asserted:

> "6. Said unpaid taxes and interest are legally due and owing to claimant and are required by law to be paid by the trustees, in advance of the payment of other claims, *in the order of priority specified in Section 64 of the bankruptcy law* (11 U. S. C. A., sec. 104, p. 123)" (R. 244).**

And concluded with the prayer:

> "Wherefore claimant prays for the dismissal of said objections, and each of them, and for allowance

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* The New Jersey Constitution provides, Art. 4, Sec. 7, Par. 12:

"Property shall be assessed for taxes under general laws, and by uniform rules, according to its true value."

** Italics throughout this brief are supplied.

of the full amount of each of said claims and interest as set forth in Schedule (A) attached thereto, respectively, together with interests on said taxes, respectively, at the rate of one percent per month and after December 1st, 1940."

In the record we have printed only claim No. 38 of the State against the debtor.

The State also filed the following claims against subsidiaries of the debtor which are still in issue:

Claim No. 34, $10,368.88 against Ogden Mine Railway Co.

Claim No. 36, $22,939.09 against Dover & Rockaway Railroad Company.

Since the issues on this appeal are raised and can be adequately dealt with as to Claim No. 38 against the debtor, we are not complicating the case with reference to the other claims, aforesaid, which are in the same basket. The details of these claims against subsidiaries with the amount of the balance claimed (erroneously described as "Amount of Levy") and dates of payment on account appear in the Record at pages 110-111 and 87-89.

On April 1, 1941, on notice to all parties including the State, the Bankruptcy Court entered Order No. 93 referring all contested claims, including the tax claims of the State, to a Special Master for hearing and report (R. 234). There had been an earlier reference in Order No. 88 to the same Special Master referring the claims on coupons on debtor's mortgage bonds to him, and he was by Order No. 93 permitted to combine his reports on the mortgage bonds and other claims, including the State's tax claims, in one report (R. 236).

1. The Railroad Tax Settlement Act of 1941 and the Events that Caused the Legislature to Enact It

a. The Factors and Events that Induced the Settlement Acts

On December 1, 1940 taxes upon property used for railroad purposes that had been accumulating against seven of the larger railroad companies since and including 1932 were in litigation in an amount approximating $34,000,000. Interest accruals claimed thereon amounted to an additional $24,000,000.

These taxes were assessed against seven major operating railroads but there was a large number of local proprietary railroad companies whose properties were used and operated as a part of said major interstate railroad systems. Four of these proprietary companies were embraced in The Central Railroad Company of New Jersey System; eleven in the Delaware, Lackawanna & Western System; fifteen or more in the Erie or Susquehanna Systems; four in the Lehigh Valley System; three in the New York Central System and four in the Reading System. There was a probability that if there were actual sales of the railroad property pursuant to the mandatory procedures of the Tax Statutes (R. S. 54:28-1) there would be a disintegration of the several railroad systems into their numerous component parts.

At this time it was the view of many sober minded people that notwithstanding the existence of newer methods of transportation the railroads were essential to industry and to society generally, and were urgently needed as factors in the war that already had partly gripped the country at the time of the passage of the first of the Railroad Tax Settlement Acts, and obviously would, as it soon did in fact, involve it as an actual participant. Those matters were all of common knowledge and served to emphasize the need in the interests of the

State for a certain and speedy method of collecting tax arrearages.

Governor Moore in a message to the Legislature in November, 1933 relating to the method of taxing railroad properties and the then existing litigations, urged that:

> "a committee representative of the Legislature and of the State be appointed that will with diligence and dispatch undertake in a painstaking and systematic manner the study of this question for the purpose of reaching some intelligent conclusion as to the course of action necessary to be taken by the Legislature for the modification or clarification of this (railroad tax) law. While it may be impossible to sustain railroad assessments to the amount which they have been assessed in recent years, it is entirely probable that some basis of rate and method of assessment may be arrived at which we can sustain in the courts, and thus end the interminable controversies which we now appear to be engaged in."

A similar message was sent to the Legislature by Governor Moore in 1934.

On January 14, 1936 Governor Hoffman in his inaugural address reminded the Legislature that the solution of the railroad tax problem was a legislative duty.

When Governor Edison took office about January 1, 1941 the unpaid balances claimed by the State for taxes and interest aggregated approximately $60,000,000. Governor Edison appointed a committee of eminent and qualified citizens, among them the Director of Princeton Surveys of Princeton University, to investigate the facts, study the questions involved and advise a solution. That committee, on February 22, 1941, made a comprehensive and widely circulated report which went into detailed facts and figures and the significance thereof. It was an economic rather than a legalistic study. The report made

certain recommendations, the first of which was that there be legislative action to permit "the payment of all railroad tax delinquencies in full, over a designated period of years, without penalty".

In the light of that report the Legislature appointed a joint legislative committee, which reported back to the two Houses a series of four recommended bills stated to be "the same bills with minor changes, prepared for the Governor's special committee by the Princeton Group and submitted" to the Legislative Committee "by Governor Edison, with his approval and recommendation". And the Legislative Committee added further that "The Princeton Surveys have vouched for the complete integrity of the research work upon which this program is based and issued a public statement to the effect that this legislation is sound and workable, and in the best interests of the people of the State".

The delinquencies had over a period of eight or nine years "run into a vast figure by reason of which the State and Municipal finances were greatly depleted. Some of the railroads had gone into insolvency, the end of which was unforseeable. Others might do so."

All of the above facts are from the very able dissenting opinion of Justice, now Chief Justice, Case in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 261 et seq.

In addition see the statement of purposes of the Legislature contained in Sec. 15 of the 1942 Settlement Act, Chapter 241, P. L. 1942, appendix annexed.

b. The 1941 Railroad Tax Settlement Act

The New Jersey Legislature passed Chapters 290 and 291, P. L. 1941, both of which were approved and became effective July 22, 1941.

Chapter 290, entitled:

> "An act relating to the collection of certain delinquent taxes upon railroad companies"

authorized in Section 1 the State Treasurer to accept without interest penalties, instalment payments of the full principal amount of property taxes upon railroad companies which were due on or before December 1, 1940 and remained unpaid on the effective date of the Act, but not unless and until the delinquent taxpayer shall have complied with the requirements of Sections 7 and 8.

Section 7 provided that any railroad, or the trustee or trustees thereof, might enter upon the execution of an instalment payment plan authorized by the Act by duly executing and filing with the State Comptroller a written undertaking in such form as the Attorney General shall prescribe for the payment of the total amount of delinquent taxes owed by the railroad or system, and paying into the State Treasury an amount not less than the first annual instalment together with interest on the unpaid balance computed in accordance with the statute.

Section 8 provided that the first payment tendered pursuant to this Act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December 1, 1941, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals concerning such assessments, all in such form as the Attorney General may require.

In Section 9 it was provided that the Attorney General be authorized and directed to execute in the name of the State any and all consents to a plan or plans of reorganization of a railroad corporation under federal bankruptcy or other laws to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the Act.

Section 4 of this Act provided that all interest penalties upon taxes paid pursuant to this Act shall be abated and cancelled, except that in addition to instalment payments interest at the rate of 3% per annum shall be paid

annually upon the balance of delinquent taxes remaining unpaid from and after December 1, 1940.

Section 5 provided that the liens of the State for taxes and interest penalties for each year in which delinquent taxes are payable shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year and interest upon any and all unpaid balances has been paid in full.

Section 6 provided that the remedies of the State for the collection of delinquent taxes shall not be enforced against any taxpayer which enters upon the execution of an instalment payment plan in the manner provided by Section 7, so long as instalment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates.

(See true copy of Chapter 290 in appendix annexed.)

Chapter 291, P. L. 1941, was a new act relating to the taxation of railroads and repealing all of the prior railroad tax laws (see P. L. 1941, Chap. 291, p. 773).

Prior to the enactment of Chapter 291, P. L. 1941, taxes were assessed on all the real property of a railroad outside of the main stem at local rates, which varied in each municipality. Property on the main stem and tangible personal property of railroads was assessed by the State Tax Commissioner at the average of the rates of all municipalities through which the main stem ran.

Under Chapter 291, P. L. 1941, two taxes were laid: (1) on all property used for railroad purposes at the rate of 3% upon the true value (Section 7), and (2) a franchise excise tax upon the net railway operating income of each system for each year (Section 13).

Furthermore, in the 1941 Act the Legislature attempted to both extend and enlarge the alleged lien of

the State. Under the former law, R. S. 54:27-4 under which the taxes were assessed, the statute imposed a lien

> "upon all the *lands and tangible property and franchises of the company in this State.* The liens shall take effect on *June 1st* of the year in which the tax is payable."

In the new tax act, Chapter 291, P. L. 1941, R. S. 54:29a-54 Pamphlet, it was provided:

> "The taxes imposed by this act or *heretofore imposed pursuant to any act* for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens *upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the 1st day of the year* in which the tax is payable."

Exact copies of the pertinent provisions of the old and new acts are in the appendix annexed.

On August 8, 1941, debtor's trustees filed in the District Court a petition for authority to compromise pursuant to Chapter 290, P. L. 1941, the controverted taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, on properties of the debtor and its subsidiaries (R. 246). In this petition the trustees reported that after the payments on account that had been authorized by the court there remained unpaid by the debtor on July 22, 1941 the following principal amount of taxes claimed by the State to be due;—

By Central Railroad Company of New Jersey	$ 13,438,669.19
By The Dover & Rockaway Railroad Company	15,185.44
By The Ogden Mine Railroad Company	5,776.23
TOTAL	$ 13,459,630.86

Trustees stated that they believed they should execute and file the undertaking provided for in Section 7 of the Act and should pay on behalf of the debtor the first annual instalment of taxes, together with stipulations, consents and other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals concerning said assessments, and they prayed that the court might order and direct them to compromise the total of delinquent taxes levied by the State, and that the trustees might be authorized to execute any undertakings, waivers, etc., required under the provisions of the Railroad Tax Settlement Act, payments to be made with interest at 3% from December 1, 1940 as required by the Act. The forms of undertakings and waiver annexed to the petition are printed in the Record, pages 250-252.

On the same day Judge Fake signed Order No. 123 authorizing the trustees to settle and compromise and pay the delinquent taxes levied by the State aforesaid, and authorizing them to execute, file and tender the undertaking and waiver substantially in the form annexed to the petition, "with such other undertakings, waivers, stipulations, consents and papers as may be prescribed or required to carry out the provisions of Chapter 290, P. L. 1941, etc." (R. 253).

The trustees, on August 11, 1941, on the authority of the order of the court of August 8, 1941, which was an acceptance of the offer of compromise contained in the State's statute aforesaid, filed with and delivered to the appropriate officers of the State all of the documents and payments required of them and subsidiary companies to comply with said offer of compromise; the trustees discontinued all of the litigation as to 1934, 1935 and 1936 taxes; they refrained from applying to the State Supreme Court for a writ of certiorari to review the decision of the State Tax Board as to the 1937 and 1938 taxes, which might have been applied for at any time prior to August

13, 1941 (as shown on page 7 hereof); and consented to the discontinuance of the pending appeals before the State Tax Board as to taxes assessed for the years 1939, 1940 and 1941.

The Attorney General made no objection to the form or sufficiency of the settlement papers, but arbitrarily refused to pass on said forms.* The State Treasurer and State Comptroller, however, have never returned the undertaking of the trustees to pay as required by the Settlement Act, nor the waivers and discontinuances, and did not return the certified checks of the trustees until May 2, 1946, when they were returned at the trustees' request, without prejudice, as provided in Order No. 333, which will be described hereafter (p. 35 hereof).

After the trustees had delivered to the appropriate officers of the State all the documents and payments required for full compliance by the debtor and subsidiary companies with the Railroad Tax Settlement Act of 1941,** David T. Wilentz, then Attorney General of New Jersey, on Sept. 4, 1941 instituted a civil information suit in the Court of Chancery of New Jersey against Robert T. Hendrickson, State Treasurer, and prayed an injunction against the State Treasurer from carrying out the provisions of Chapter 291, P. L. 1941, on the allegation that said statute was in violation of Article I, Par. 20 of the New Jersey Constitution, which provides that:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation to or for the use of any society, association or corporation whatever."

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* The Attorney General refused to perform this ministerial act, although it has never been suggested that the documents executed and filed by the trustees were not effective, and completely binding on the trustees.

** The Act set up a formula for determining over what number of years the taxes might be paid in annual instalments. Under this formula debtor's taxes were payable over a period of 20 years.

No other party was named or appeared in said suit. No application was made to the Bankruptcy Court to make the trustees of the debtor parties to this suit nor was the State Comptroller made a party, although he acted for the State in signing and verifying the proofs of claim that had been filed in the Bankruptcy Court and under the Settlement Act the "undertaking" prescribed was required to be filed with the Comptroller (R. 50, par. 16).

As December 1, 1941 approached, the date on which taxes levied for the year 1941 became payable, the trustees, in view of the action of the Attorney General in attacking the constitutionality of the Settlement Act and in view of the further fact that the trustees in accepting the offer of settlement therein contained had waived an appeal from the 1941 assessment which had been filed with the State Tax Board on instructions of the Bankruptcy Court before the Settlement Act was complied with, filed a petition with the court for instructions whether under all of the circumstances they should pay the taxes as levied for the year 1941 (R. 268).

Hearing on this petition was held before Judge Fake in the reorganization court on November 24, 1941 (the State not being represented although it had notice), and on the same day the court signed Order No. 135 finding, adjudicating and decreeing that the Trustees had taken all steps necessary on behalf of the Debtor's Estate to comply with the provisions of the Settlement Act and in view of such compliance authorized the Trustees to pay the State in full, on or before December 1, 1941, the taxes assessed against the Debtor and its subsidiaries for 1941.

The Attorney General did not object to or appeal from said Order 135 but on the contrary the State accepted the trustees' check for the 1941 taxes which it directed to be paid.

2. The Tax Settlement Act of 1942

The information suit which Attorney General Wilentz had filed in the Court of Chancery against the State Treasurer was defended by the State Treasurer through special counsel employed by the State, and the Legislature appropriated $50,000 for the defense of this action (see Chap. 391, P. L. 1941, approved Dec. 23, 1941).

The next (1942) Legislature passed Chapter 241, P. L. 1942, approved by the Governor to take effect immediately (May 21, 1942). This law amended the title of Chapter 290, P. L. 1941, as well as the body of that law (a copy is annexed hereto as part of the appendix). This act followed closely the terms of the 1941 Act, but prescribed the exact form of the settlement papers and left no ministerial duties to the Attorney General. Among other things this Act provided, amending Sec. 1 of the 1941 law:

> "Any railroad taxpayer desiring to accept the provisions of this Act shall, on or before June fifteenth, One Thousand Nine Hundred and Forty-two, file with the State Treasurer the acceptance document required by this Act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this Act, and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, One Thousand Nine Hundred and Forty-one, pursuant to the applicable tax acts, and of any assessment heretofore or *hereafter* made for the tax year One Thousand Nine Hundred and Forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals

respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this Act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this Act."

The significance of the phrase requiring the railroad taxpayer accepting the provisions of the Act to pay "any assessment heretofore or *hereafter* made for the tax year One Thousand Nine Hundred and Forty-one" in the above section, is due to the fact that Chapter 169, P. L. 1942, was approved by the Governor May 8, 1942 and took effect immediately. This law amended the Railroad Tax Act of 1941 (P. L. 1941, Chap. 291), and imposed an additional retroactive franchise tax on the debtor for 1941 in the amount of $239,748.80 (See P. L. 1942, p. 516, Sec. 4 amending Sec. 73 of the Tax Act of 1941).

The amended Tax Settlement Act of 1942 (Chapter 241) further provided in Section 4, amending Section 3 of the 1941 Settlement Act:

"The initial payment to be made under this Act shall be made on or before June fifteenth, One Thousand Nine Hundred and Forty-two, and shall be an amount not less than the first annual instalment computed as herein provided."

It also provided:

"All such unpaid taxes shall bear interest at the rate of three percent. (3%) per annum to be calculated from and after December first, One Thousand Nine Hundred and Forty. The initial payment shall include such interest to the date of such payment and each subsequent payment shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding instalment payment."

This latter provision required the trustees to make an additional interest payment on or before June 15th in an amount exceeding $340,000 upon the entire principal of taxes claimed by the State as of December 1, 1940, without deducting therefrom the first instalment of principal tendered under Order No. 123 of August 8, 1941.

On May 21, 1942, the day on which Chapter 241, P. L. 1942 was approved, the Attorney General filed a supplemental civil information in the Court of Chancery challenging the constitutionality of said Chapter 241 on the same grounds as were alleged in his original information (R. 276, par. 15).

The trustees had only the period between May 21, 1942, when Chapter 241, P. L. 1942 was approved by the Governor, and June 15, 1942 (Section 4) to secure court approval of the acceptance of the settlement contained in Chapter 241 and to comply therewith.

The trustees accordingly filed their petition, verified on June 2, 1942 (R. 270), for instructions whether they should comply with the 1942 Act, which recited the filing of the State's Claim No. 38 for taxes by the Comptroller on December 10, 1940; the reference of said claim by Order No. 93 to a Special Master; the order the court had made on August 8, 1941, (No. 123) authorizing the trustees to compromise and pay the principal amount of the State's claims pursuant to the terms of Chapter 290, P. L. 1941, and the trustees' compliance therewith; and the Order No. 135 finding that the trustees had complied with the terms of the offer of compromise contained in the Settlement Act and directing petitioners to pay in full the taxes assessed against the debtor by the State for 1941.

The trustees' petition also recited the passage by the Legislature of Chapter 169, P. L. 1942, amending the franchise tax payable by railroads under the 1941 law, and alleged that the taxes payable by certain other railroads for the year 1941 were thereby reduced but that the franchise taxes against the debtor were retroactively in-

creased by the 1942 Act for the year 1941 in the amount of $239,748.80.

The court was advised in said petition that new and additional acceptance documents and waivers were required by the 1942 Act (Chapter 241) and that the trustees would be required to waive any and all rights to contest the legality of the additional assessment retroactively made against the debtor for 1941. The court was further advised that grave doubt existed as to the legality and constitutionality of the retroactive levy and assessment against the debtor for the year 1941 above mentioned, and the reasons therefor.

On the filing of this petition the District Court made an order (No. 161) requiring the Attorney General, the Comptroller and the Treasurer of the State and all parties, to show cause at a hearing to be held June 8, 1942 why the amount of the tax claim of the State against the debtor for 1932 to 1939 should not be fixed and adjudicated at the principal amount of taxes alleged to be due, payable at the times, with interest and upon the terms and conditions prescribed by Chapter 241, P. L. 1942, and why the interest and penalties as claimed by the State should not be disallowed and dismissed (R. 278).

On the return of this order to show cause and after hearing the Attorney General, the Comptroller and counsel for the State Treasurer and other parties, the court made its Order No. 163 allowing the State's tax claim for the amount of the principal of the taxes as shown by Claim No. 38 of the State, and instructing and directing the trustees, on or before June 15, 1942, to comply with the provisions of Chapter 241, P. L. 1942, and it adjudged that upon full compliance as aforesaid the claims of the State will have been fully satisfied and discharged.

The trustees thereupon fully complied in all respects with Chapter 241 not only as to taxes assessed by the State against the debtor for 1932 to 1940 inclusive, but also as to all taxes claimed from subsidiaries of the debtor,

and waived any and all right to contest the legality or amount of said retroactive franchise tax in the amount of $239,748.80 for 1941, which the trustees paid in good faith and without contest, and for the recovery whereof the laws of the State provide no right or remedy. They also paid, as required, said $340,000 of additional interest, and also filed and delivered to the appropriate State Officers all of the documents and papers required for full compliance with the terms of Chapter 241 by affiliated companies (R. 54, par. 21).

It thus appears that the Trustees, on orders of the District Court, fully accepted the offers of compromise made by the State in the form of Chapter 290, P. L. 1941 and Chapter 241, P. L. 1942 and complied therewith in all respects. After thus complying all pending appeals and all litigation wherein taxes assessed by the State for the years 1934 down to 1941 were being litigated, were discontinued.

It is to be noted that the trustees' compliance with the 1941 statute was fully completed before the Attorney General filed his information suit in the Court of Chancery.

The Attorney General appealed to the United States Circuit Court of Appeals from Order No. 163 on the ground, among others, that the District Court determined the amount of taxes due the state on its claims, which the State contended was a determination of the constitutionality of the Tax Settlement Acts, although the District Court at the Attorney General's request, in the order expressly disclaimed passing upon the validity of the acts.

The Circuit Court of Appeals, however, in *In re Central Railroad Company of N. J.*, 136 Fed. (2d) 632 (rehearing denied June 15, 1942; cert. den. 320 U. S. 805) reversed so much of said order as purported to determine the amount of tax payable to the State and concluded:

> "One final point must be noticed. Order No. 163 authorized the trustees of the debtor to comply with

the Tax Settlement Acts by executing and filing the documents and making the payments therein required. Since the law directed that these steps be taken on or before June 15, 1942, it is vitally important to the debtor in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the tenders made by the trustees prior to that date pursuant to the directions of Order No. 163 be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustees to comply with the requirements of the Tax Settlement Acts will not be disturbed."

The cause was remanded to the District Court

"with directions to the District Court to await the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the debtor and its creditors may result, in which event it may proceed itself to hear and decide the constitutional issue."*

We assume that this court in denying the trustees' petition for a writ of certiorari, to review said action of the Circuit Court, 320 U. S. 805, did so because it considered it best to await the decision of the State Courts, for if they should determine the Settlement Acts were constitutional the controversy would be at an end. Moreover the order of the Circuit Court of Appeals was not a final order.

* It will be observed that the Circuit Court thus concedes the jurisdiction of the Bankruptcy Court to determine this question but it obviously did not seriously consider that court's paramount power to determine the effect of the State's compromise offer to the Federal Court and the acceptance thereof.

a. The decision of the State Courts

On September 28, 1943, more than a year after the trustees had complied with the amended Settlement Act and had under the direction of the Bankruptcy Court in good faith waived all their rights further to contest the taxes claimed by the State for the years 1934 to 1941 inclusive, and had paid without contest the retroactive franchise tax of $239,748.80 for the year 1941 and the additional and accelerated interest aggregating $340,000 above mentioned, the Court of Chancery entered a decree in *Wilentz* v. *Hendrickson,* 133 N. J. Eq. 447. The Vice-Chancellor in his opinion held that the Settlement Acts violated Art. I, Par. 20 of the New Jersey Constitution aforementioned and enjoined the State Treasurer from complying therewith.

The State Treasurer appealed from this decision to the New Jersey Court of Errors and Appeals, which, on June 22, 1944, affirmed the decree of the Vice-Chancellor on the ground that the remission, cancellation and abatement of delinquent interest due from the railroads was not supported by legal, equitable or moral consideration, and that accordingly the amended Settlement Act amounted to an appropriation of money for the railroad corporations in violation of Art. I, Par. 20 of the State Constitution [135 N. J. Eq. 244].

It is to be observed from the opinion in *Wilentz* v. *Hendrickson* that the cause was submitted to the Vice-Chancellor in the controversy between the Attorney General and the State Treasurer on a stipulation of facts (135 N. J. Eq. at p. 250). There were no other parties to this action than the State officers. The opinion of the Court of Errors and Appeals said:

> "Is the remission, cancellation and abatement of the tax debt (delinquent interest) supported by a legal, equitable or moral consideration? The learned

Vice Chancellor answered that question in the negative. Here, too, we are entirely satisfied that the proofs and authorities upon which he relied support his answer."

The proofs consisted of the facts stipulated between the State Attorney General and the State Treasurer. They were not and could not have been the facts peculiar to the situation of the debtor.

b. The Trustees' Petition for Adjudication of the State's Tax Claims on which the Issues here presented were raised

On August 14, 1944, within two months after the decision of the Court of Errors and Appeals in *Wilentz* v. *Hendrickson, supra,* the trustees filed in the Bankruptcy Court their "Petition for Adjudication Concerning New Jersey Tax Claims", in which they stated the history of the matter as hereinabove recited, but in less detail, and prayed that the court promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey; (2) whether such contract, *i. e.,* compromise, is binding on the parties thereto; (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them; (4) if not binding on the parties thereto, including petitioners, to what extent if at all the proofs of claim of the State of New Jersey should be allowed; (5) what order should in such event be made to restore the equivalent of the *status quo ante* as nearly as may be; and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate; and that the court may instruct petitioners whether to make, on or before December 1, 1944, the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290, P. L. 1941, as amended by Chapter 241, P. L. 1942 (R. 63).

The Attorney General, after being served with a copy of the above petition, filed a special appearance objecting to the jurisdiction of the Bankruptcy Court to entertain said petition on the ground that same constitutes "the maintenance of a suit, claim or demand against the State of New Jersey, by citizens thereof, beyond the judicial power or jurisdiction of any court of the United States to entertain", and prayed that the petition of the trustees shall be "dismissed insofar as same prays for or seeks an adjudication or determination that the claims of the State of New Jersey for taxes and interest thereon are less than such sums as have been assessed against the debtor and the trustees by the duly constituted authorities of the State, or have lawfully accrued, pursuant to the laws of the State, and insofar as the liens of the State for such taxes and interest are sought in any wise to be altered, affected, modified or destroyed by any such adjudication or determination" (R. 79).

The Bankruptcy Court thereupon, by Order No. 250, re-referred the State's tax claims, the trustees' objections thereto, and the State's reply to said objections, the trustees' petition for adjudication and the aforesaid purported special appearance on behalf of the State objecting to the court's jurisdiction to consider the trustees' petition for adjudication of the State's tax claims to Augustus C. Studer, Jr., as Special Master, for hearing and report (R. 80).

The Special Master, after hearing attended by the Attorney General and representatives of bondholders' committees and the trustees, filed an Interim Report on January 17, 1945 (R. 116), in which he found that:

> "the entire property of the railroad is *in custodia legis*, subject, however, to such rights as are given by law to lien-holders. • • • Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in the case of Arkansas Corporation Commission v. Thompson, 313 U. S., p. 132,

which limitation is not now involved, is the proper court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the court. Isaacs v. Hobbs Tie & T. Co., 282 U. S. p. 734, at p. 738.

"It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the trustees should not be dismissed" (R. 39).

The Attorney General, on January 27, 1945, filed objections to the Interim Report of the Special Master. The court, after argument on February 21, 1945, filed an opinion confirming the opinion of the Special Master (R. 137), and on March 5, 1945 made Order No. 271 confirming the Special Master's Report and overruling the objections of the State (R. 138).

On April 2, 1945, the State by its Attorney General appealed from Order No. 271 to the Circuit Court of Appeals (R. 141).

Prior to the argument of this appeal in the Circuit Court of Appeals, the Attorney General filed in the Circuit Court of Appeals a petition for a writ of prohibition forbidding and preventing the District Judge and Special Master from proceeding with the determination of any matters or the making of any adjudication in connection with the tax debt lien of the State for the years 1932 to 1939 inclusive (R. 10).

In response to the order to show cause issued by the Circuit Court (R. 22), Judge Fake filed an answer which appears at R. 22, in which he said, among other things, that:

"No party to the proceedings has challenged the principle of sovereign immunity or the principle that the custody and title of the Trustees of the debtor

of and to the estate *in custodia legis* is subject to pre-existing liens. However, the added and extended concept advanced on behalf of the State has been challenged, viz., the concept that the estate *in custodia legis* consists of 'only the interest of the Debtor over and above' liens and that 'the court has only that equity which the debtor had immediately prior to the inception of the proceedings.' It is that argument or concept which has been rejected by said Order No. 271 and, as well, the assumption that the quantum, rank and extent of security of a lien claim asserted by a state must be accepted and the lien claim allowed exactly as set forth by the State in its proof of claim and without any scrutiny or determination by the Bankruptcy Court of any issues raised with respect thereto by the Trustees and other parties to the reorganization proceedings" (R. 24, par. 9).

The Circuit Court of Appeals in its opinion referred to the long line of litigation which had for several years occupied the Federal Courts and both the judicial and other branches of the State government (R. 148); it reviewed the State legislation (R. 149); the federal litigation preceding bankruptcy (R. 150); the federal litigation after bankruptcy (R. 151); analyzed the New Jersey method of taxing railroad property during the taxable years (R. 153); the method of reviewing assessments by the State Tax officers (R. 157); considered what the court conceived to be the applicable law (R. 159); and concluded with the statement that the instant problem is brought within the doctrine of the *Arkansas* and *Monongahela* cases, and that "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment."

The last paragraph of the opinion provides that Order No. 271 be reversed and that the application for a writ of prohibition be dismissed (R. 167).

Shortly after this opinion was filed Shelton Pitney, one of the trustees, who had conducted the litigation, died; the time to file a petition for rehearing was extended, and a petition for rehearing was filed March 21, 1946 (R. 170).

One further detail remains to be mentioned. Since undertaking to comply strictly with the terms of the Settlement Act beginning on August 11, 1941, the trustees have duly tendered to the State Treasurer certified checks covering each of the instalments of principal and interest required by said Acts. As a result, the State Treasurer up to May 2, 1946 held certified checks of the trustees aggregating $3,577,689.52, representing tenders that the trustees had made in compliance with the Settlement Acts (R. 298).

D. Present Status of the State's Tax Claims

In view of the contention of the Attorney General that the Settlement Acts being held void by the State Courts are also void here, and that the tenders were therefore annulled and that penalties at the rate of 1% per month are continuing to accrue on the principal amount of taxes claimed by the State from the date said taxes were assessed in each year, the surviving trustee, on April 15, 1946 (after a petition for certiorari had been filed in this court) filed in the Bankruptcy Court a petition (R. 287) asking the instructions of the court whether he should at that time pay out of the funds in his hands to the State the sum of $13,413,669.19 or some other sum in such way and manner as will protect the debtor's estate and stop the further running of penalties and interest on the amount so ordered paid. Exhibit "A" annexed to said petition specified the amounts of the tenders that had been made and the division thereof between principal and interest if applied under the Settlement Acts (R. 296).

After notice to all parties a hearing was held April 26, 1946 before the court (R. 298), at which the Attorney

General and many other parties appeared (R. 299), which resulted in Order No. 333 being made (R. 296), and consented to by the Attorney General (R. 298) directing the trustee to pay to the State within ten days the sum of $15,250,000 in cash on account of the tax claims of the State for the years 1932 to 1940, inclusive, including interest thereon, if any, said payment to be made under the terms specified in the order (see the terms, R. 297-298).

Paragraph 2 of said order is important. It reads as follows:

> "Except as otherwise provided in paragraph 1 of this order, the making of said payment by the trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of, or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey."

It was provided in paragraph (c) that in making the payment the trustee might use the certified checks aggregating $3,577,689.52 theretofore tendered to the State of New Jersey, "and for that purpose may regain possession of and surrender said checks for cancellation, without prejudice to the effectiveness of said tenders or any other tenders or the legal consequences that may be found to have ensued therefrom" (R. 298).

The State Commissioner's receipt for the Trustee's payment of $15,250,000 was dated May 6, 1946 (R. 318).

In view of this payment it is the petitioner's position that the tax liability of the debtor to the State of New Jersey, has now been fully discharged.

IV

Specification of Errors

The errors stated in the petition for rehearing and assigned here are as follows:

(1) The Circuit Court of Appeals erred in holding that the jurisdiction of the Bankruptcy Court under the peculiar facts of this case was limited to passing upon mathematical errors, or errors of law in the assessments.

(2) The Circuit Court of Appeals erred in failing to pass on the primary issue raised by the State's appeal, i. e. whether or not the nature, amount and priority of the State's alleged lien is within the jurisdiction of the Bankruptcy Court.

(3) The Circuit Court of Appeals erred in failing to recognize the broad functions of the Bankruptcy Court in the practical administration of Section 77 of the Bankruptcy Act, 11 U. S. C. A. 205.

(4) The Circuit Court of Appeals erred in denying the right of the Bankruptcy Court to determine whether a valid agreement of compromise, binding on the State and the trustees, had been made by the State passing the Railroad Tax Settlement Acts and the trustees accepting the provisions thereof, on court order, which involved the waiver of excessive and uncollectible penalties by the State on the one hand, and on the other the discontinuance and abandonment by the trustees of pending appeals in State tribunals and in the courts from excessive assessments and illegal rates and an undertaking to pay the principal of the disputed taxes with interest at 3%, including the payment of retroactive and discriminating

franchise taxes assessed retroactively during the bankruptcy proceedings, and the payment of large additional interest items.

(5) The Circuit Court erred in reversing Order No. 271.

Summary of Argument

(1) The State's plea that the trustees' petition for adjudication as to the State's tax claims is a suit against the State without its consent is without merit because: (a) the State filed in the proceedings, as required by Section 57(n) of the Bankruptcy Act, its verified proof of claim; (b) the Attorney General representing the State appeared generally in the proceedings both before and after the proof of claim was filed and demanded and the State accepted payments on account of its tax claims aggregating $18,000,000, which the trustees, on Court order, paid out of general assets of the debtor; (c) all of which amounted to a waiver by the State of all immunity respecting the complete adjudication of said claims.

(2) The Bankruptcy Court has exclusive jurisdiction to determine all questions as to the amount, priority and legality of the State's tax claims not only because of the provisions of the Bankruptcy Act which now require a State to file its claim in the proceedings and further provides that in case any question arises as to the amount or legality of any taxes such question shall be heard and determined by the Court; but also because it is thoroughly settled by a long line of decisions of this Court that the filing of a petition is an assertion of jurisdiction by which the Bankruptcy Court acquires exclusive jurisdiction within the field of the law and the sweep of federal statutes and under equitable principles to determine all questions in the proceedings relating to claims, liens, assets and the administration thereof, to the end that a fair and equitable plan for the reorganization of the debtor may speedily be devised.

(3) The Circuit Court of Appeals erred in reversing the order of the District Court which referred all matters arising from the State's claims and the objections thereto to a Special Master and in determining that the only matters left open for decision were mathematical error in the computation of the amount of taxes or legal error in their assessment, because, among other reasons, the trustees had properly raised the question whether a compromise of the State's claims had been effected under Section 27 of the Bankruptcy Act by the State passing and the trustees, on court order, accepting the provisions of Railroad Tax Settlement Acts of 1941 and 1942 and fully complying therewith. The trustee contends that said compromise is valid not only under Section 27 of the Bankruptcy Act but also under New Jersey law, and that the decision of the State Courts in *Wilentz* v. *Jendrickson*, on which the Attorney General relies and in which neither the debtor nor the trustees were parties, is not *res adjudicata*.

(4) A substantial question which the Circuit Court ignored and which must be decided before there can be a reorganization of the debtor is whether the State has lost its alleged lien for taxes (a) by demanding and accepting payments on account aggregating $18,000,000 out of the general funds of the debtor; (b) by repealing the statute which gave the lien asserted and at the same time enacting a new tax law which attempts not only to preserve but also to change the date when the alleged lien became effective in each year and extend the lien to assets of the debtor that were not covered by the lien under the law in existence when the taxes were assessed; and (c) by accepting payments from the debtor's trustees equal to the principal of the taxes in default plus 3% interest from December 1, 1940, in accordance with the provisions of the Tax Settlement Acts, which in terms provided that when such amounts were paid the lien of the State was discharged.

POINT I

The State's plea that the trustees' petition for adjudication as to the State's tax claims is a suit against the State, without its consent, is without merit.

We have shown in the Statement of Facts how the State, by its Attorney General, appeared in the reorganization proceedings and applied for orders directing that something be paid on account of taxes before trustees were appointed, and after trustees were appointed urged that as much as possible be ordered paid on account of taxes.

The State, by its Comptroller, filed its proof of claim (R. 64) for over $12,000,000 in taxes and nearly $8,000,000 in penalties, verified December 15, 1940. When objections were filed by the trustees to the tax claims the Attorney General for the State filed a reply on March 26, 1941 (R. 242), and when the trustees filed supplemental and amended objections and defenses to the State's claims the Attorney General for the State filed an elaborate reply thereto (R. 90). When a bondholders' committee and trustee on the debtor's mortgage filed objections to the State's claim (R. 112), dated November 22, 1944, the Attorney General for the State filed a reply thereto on December 28, 1944 (R. 115).

The claim of the State was filed as required by Section 57(n) of the Bankruptcy Act, Tit. 11, U. S. C. A., Sec. 93(n), amendment of June 22, 1938, C. 575, Sec. 1, 52 Stat. 866.

The Attorney General can scarcely assert that the State Comptroller lacked authority to file a proof of claim, because N. J. R. S. 52:19-10 authorizes and directs the State Comptroller to

> "institute and direct prosecutions * * * for just claims and debts due to the State."

And R. S. 52:19-15 directs that

> "The Comptroller shall cause suit to be instituted in any competent court of this or any other State for the recovery of any moneys due to the State * * *. The suit shall be in the name of the 'State of New Jersey' as plaintiff."

The Attorney General's further contention that since he alone has authority to enforce the State's liens the Comptroller lacked authority to file a proof of claim in a bankruptcy proceeding is disposed of by N. J. R. S. 54:27-4, which provides respecting railroad taxes as follows:

> "the taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State. The liens shall take effect on June 1st of the year in which the tax is payable, and *shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained* and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this title."

The "special proceedings" referred to for enforcing the State's alleged lien consists of the entry by the Attorney General of a summary judgment in the Supreme Court and thereafter the issuance of execution directed to a Master in Chancery to make sale. The threat of this special proceeding is what caused the debtor to file its petition for reorganization in 1939.

It thus appears that the statutes authorize as remedies for the collection of delinquent railroad taxes (a) an action at law for debt, (b) a suit in equity to foreclose the tax liens, (c) the assertion of a "preferred debt in case of insolvency" and (d) a special proceeding by the Attorney

General to enforce the lien. Obviously the Attorney General's assumption that the only remedy provided by law for the collection of the taxes in question is a proceeding by him to enforce the lien is wholly unfounded. The legislature evidently anticipated that, under certain conditions, the enforcement of a tax lien might not be a satisfactory remedy and so provided the three other remedies referred to, including, in the case of an insolvent taxpayer, the presentation of the State's claim as a "preferred debt", and in addition expressly authorized the State Comptroller to "institute" suit on such a tax claim "in any competent court."

It is submitted that the filing of the State's proof of claim by the State Comptroller in the Bankruptcy Court was expressly authorized, and said claim having been duly filed, invoked the jurisdiction of the Bankruptcy Court.

The above considerations completely dispose of any suggestion that the State did not submit itself to the Court's jurisdiction. The Attorney General, however, next contends that even though the State filed its claim in the Bankruptcy Court and urged and accepted very large payments thereon, nevertheless the State intended only to protect its claim for any deficiency and has refrained from submitting to the Court for adjudication any question respecting its alleged lien, and that therefore the Bankruptcy Court can make no determination that will in any way affect said lien.

It is submitted that the answer to these contentions is found (1) in the nature and effect of a sworn proof of claim; and (2) in the Bankruptcy Act, Section 57 (Tit. 11, U. S. C. A., Sec. 93); Section 64 (Sec. 104, 11 U. S. C. A.) and Section 77. (Sec. 205, 11 U. S. C. A.)

(1) The filing of a sworn proof of claim is *prima facie* evidence of its allegations (*Whitney* v. *Dresser*, 200 U. S. 532). When such a claim is filed, if it is disputed, it becomes the duty of the trustee, or other persons in interest

duly to object to the allowance thereof. Obviously the filing of such objections does not constitute a suit against the state. *Wiswall* v. *Campbell*, 93 U. S. 347, 351; *In re General Film Corp.*, 274 Fed. 903 (C. C. A. 2nd 1921); *In re Williams Oil Corp.*, 265 Fed. 401 (D. C. Ky. 1930); *In re McClure*, 21 Fed. 2nd 538.

(2) Section 77 (b) (1), 11 U. S. C. A. 205 (b) (1) as enacted in 1933 provides that any plan of reorganization

> "shall include provisions modifying or altering the rights of creditors generally, or of any class of them, *secured or unsecured*, either through the issuance of new securities of any character or otherwise."

and paragraph (b) (5) provides that the plan

> "shall provide adequate means for the * * * satisfaction or modification of any *liens*, indentures, or other similar interests, the curing or waiver of defaults", etc.

The same paragraph provides that the term

> " 'claims' includes debts whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), *liens*, or other interests of whatever character."

In 1938, five years after the above all-inclusive provisions were enacted in Section 77, Section 57 of the Bankruptcy Act, 11 U. S. C. A. 93 (d), was drastically amended, doubtless in the light of the new provisions of Section 77, so that today Section 57, paragraph (d), provides that:

> "Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court unless objection to their allowance shall be made by parties in interest."

Paragraph (f) of that section provides that:

> "Objections to claims shall be heard and determined as soon as the convenience of the court * * * will permit."

Paragraph (n) provides that:

> "all claims provable under this title, including all claims of the United States, *and of any State or subdivision thereof*, shall be proved and filed in the manner provided in this section."*

We submit that it is thoroughly settled by the decisions of this court in *Isaacs, Trustee* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 1931 and *Straton* v. *New*, 283 U. S. 318,

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* The House Committee Report (House Rep. 1409, 75th Cong., First Sess., at p. 13), recommending the a ve amendment of Section 57 (n) stated:

> *"All proofs of claim, except as otherwise provided in chapters X, XI, XII, and XIII, including claims for taxes and debts owing to a government, must be filed and proved.* The provision in respect to government claims is added in order to overcome the decisions which hold that the bar time for the filing of claims is not binding upon a sovereign. Thus the administration of the estate is speeded up, and the distribution becomes more certain and definite."

and the Senate Committee Report (Sen. Rep. 1916, 75th Cong., Third Sess., pp. 5, 6 and 16) stated:

> "The committee agrees with the proposal that governmental claims should be subjected to the same requirements as other claims * * *."
>
> "The provisions relative to the proof and allowance of claims have been greatly improved. Reference has already been made with reference to contingent claims and concerning the filing of Government claims and the extension of time therefor."

Thus the very purpose of this amendment was to "subject governmental claims to the same requirements as other claims" as had already been done by the broad language of Section 77.

that the jurisdiction of the Bankruptcy Court to determine the questions raised in the trustee's petition for adjudication is not only exclusive but that it is broad enough to make every determination necessary to accomplish the purposes of reorganizing the debtor in the manner provided by the Bankruptcy Act.

The State, having appeared in the reorganization proceedings in the manner it did and having filed its claim and having filed answers to the objections thereto, has waived all immunity respecting the complete adjudication of said claim. *Clark* v. *Barnard*, 108 U. S. 436, 447; *Gunter* v. *Atlantic Coast Line*, 200 U. S. 273, 284; *Porto Rico* v. *Ramos*, 232 U. S. 627; *Missouri* v. *Fiske*, 290 U. S. 18. See, also, *In Re Barnett*, 12 Fed. (2d) 73 (C. C. A. 2nd); cert. den. 273 U. S. 699.

POINT II

The Bankruptcy Court has exclusive jurisdiction to determine, and must determine in these proceedings, (A) the nature and extent of the State's alleged liens; and (B) the amount, priority and legality of the State's tax claims.

A

As to the Nature and Extent of the State's Alleged Liens

The Bankruptcy Court has at all times had exclusive jurisdiction as to the nature and extent of all types of liens asserted in bankruptcy proceedings.

In *Ex parte City Bank of New Orleans*, 3 How. 292 (1845), which arose under the Bankruptcy Act of 1841, a mortgagee of property owned by a bankrupt, without filing a claim in the Bankruptcy Court, undertook to foreclose his mortgage in a State Court, an issue being sharply raised as to the power of a Bankruptcy Court to deal with the rights of a lien holder. The mortgagee contended that in view of the provisions of the early Bankruptcy Act that nothing therein "shall be construed to annul, destroy or impair any lien", it followed that the Bankruptcy Court had no jurisdiction over the mortgage.

In rejecting this argument Mr. Justice Story, speaking for a unanimous court, said:

> "There is no doubt that the liens, mortgages and other securities within the purview of this proviso, so far as they are valid by the State laws, are not to be annulled, destroyed or impaired under the proceedings in bankruptcy; but, they are to be held of equal obligation and validity in the courts of the United States as they would be in the State courts.

> "The District Court, sitting in bankruptcy, is bound to respect and protect them but this does not and cannot interfere with the jurisdiction and right of the Bankruptcy Court to inquire into and ascertain the validity and extent of such liens and mortgages, and other securities, and to grant the same remedial justice and relief to all the parties interested therein as the State courts might or ought to grant * * *. The rights and remedies in such cases are entirely distinct. While the former are to be fully recognized in all courts, the latter belong to the *lex fori*, and are within the competency of the national courts equally with the State courts" (pp. 315, 316).

In answer to the suggestion that assumption of jurisdiction by the Bankruptcy Court would operate to suspend or control proceedings in the State Courts, the opinion explained that the Bankruptcy Court would exercise its control,

> "not by acting on the (State) Courts over which it possesses no authority; but by acting on the parties through the instrumentality of an injunction * * *."

As justification for the Bankruptcy Court thus assuming jurisdiction of liens affecting the property of a bankrupt, the opinion continued:

> "The judicial power of the United States is by the constitution competent to all such purposes; and Congress by the Act intended to secure the complete administration of the whole system in its own courts as it constitutionally might do" (p. 320).

And further:

> "The truth is that in no other way could the bankruptcy system be put in operation without interminable doubts, controversies, embarrassments and diffi-

culties, or in such manner as to achieve the true end and design thereof. Its success was dependent upon the national machinery, being made adequate to all the exigencies of the Act" (p. 321).

In re Tyler, 149 U. S. 164 (1893), while property of an insolvent was in the custody of a receiver appointed by the Federal Court, a sheriff seized it on account of State taxes and when arrested by a United States Marshal for contempt defended on the ground that, while unauthorized interference with property *in custodia legis* is ordinarily punishable as contempt, that principle does not apply to the collection of State taxes and that the process against him was therefore a suit against the State. This Court held that the rule as to *custodia legis* applied where a State tax lien was involved, as in other cases, saying:

"• • • And when controversy arises as to the legality of the tax claimed there ought to be no serious difficulty in adjusting such controversy upon proper suggestion. The usual course pursued in such cases is by intervention pro interesse suo, as in the instance of sequestration. (Citations.) The tax collector is a ministerial officer (citations); and no reason is perceived why he should not bring his claim to the attention of the Court, while, on the other hand, it is clearly the duty of the receiver to do so if he contends that the taxes are illegal. If found valid, they must be paid; if invalid, the Court will so declare, subject to the review of the appellate tribunals."

This holding was subsequently approved by a unanimous court in the opinion by Mr. Justice Brandeis in *Marshall v. New York*, 254 U. S. 380 (1920), where the court said:

"Since the prerogative right of the State could not be enforced by levy and seizure, an application

to the court for payment of the debt due was the appropriate remedy."

In *First National Bank* v. *Staake*, 202 U. S. 141 (1906), a question arose as to the validity of a decree of a Bankruptcy Court preserving, under Section 67(f) (11 U. S. C. A. 107(f)) for the benefit of creditors, a voidable lien that had been secured within four months of bankruptcy. In holding the decree valid, this Court said:

> "To what extent liens obtained by prior judicial proceedings shall be recognized is a matter wholly within the discretion of Congress • • •" (p. 148).

And in answering the contention of the lien creditor that his lien was beyond the reach of the court, the opinion continued:

> "The general rule relied upon by the bank (the attaching creditor) in this case that the words 'property of the bankrupt' mean only the property to which the bankrupt is beneficially entitled and do not include property to which he has only a bare legal title, is perhaps justified by our decision, in Hewit v. Berlin Machine Works, 194 U. S. 296. But the extent to which the Bankruptcy Court shall recognize the rights obtained by creditors upon property attached as the property of the bankrupt, though in fact, such property had been conveyed by an unrecorded contract, is a matter solely within the discretion of Congress. The liens acquired in this case were liens upon property which, as to attaching creditors, was the property of the bankrupt, and Congress may lawfully insist that it shall be reckoned as a part of his estate, and passed to the Trustee" (p. 149).

In *Isaacs, Trustee* v. *Hobbs Tie & Timber Co., supra,* the question was presented whether, after a Bankruptcy

Court had acquired jurisdiction, a lien creditor of the bankrupt, who had filed no claim, might proceed in a State Court to foreclose. This court (Mr. Justice Roberts) said:

> "Upon adjudication, title to the bankrupt's property vests in the trustee with actual or constructive possession, and is placed in the custody of the Bankruptcy Court. Mueller v. Nugent, 184 U. S. 1, 14. The title and right to possession of all property owned and possessed by the bankrupt vests in the trustee as of the date of the filing of the petition in bankruptcy, no matter whether situated within or without the district in which the court sits. Robertson v. Howard, 229 U. S. 254, 259-260; Wells v. Sharp, 208 Fed. 393; Galbraith v. Robson Hilliard Grocery Co., 216 Fed. 842. It follows that the bankruptcy court has exclusive jurisdiction to deal with the property of the bankrupt estate. It may order a sale of real estate lying outside the district. Robertson v. Howard, supra; In re Wilka, 131 Fed. 1004. When this jurisdiction has attached the court's possession cannot be affected by actions brought in other courts."

And further:

> "Thus, while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation. Ex Parte City Bank of New Orleans, 3 How. 292; Houston v. City Bank of New Orleans, 6 How. 486; Ray v. Norseworthy, 23 Wall. 123; In re Wilka, supra; Nisbet v. Federal Title & T. Co., 229 Fed. 644."

In *Straton* v. *New, supra,* the District Court entered an order in the bankruptcy of the Fall Branch Coal

Company, enjoining commissioners appointed by a West Virginia State Court from proceeding with the sale of certain real estate of the bankrupt pursuant to a decree of that court. The trustee's petition alleged that commissioners were advertising for sale only the property of the bankrupt in West Virginia, that it would be advantageous to all parties to have this property sold with property of the bankrupt situate in Kentucky, and that the Bankruptcy Court had exclusive jurisdiction to make the sale. Respondents in their answer denied the right of the Bankruptcy Court to enjoin the proceedings in the State Court and appealed from an order awarding an injunction. This court (Mr. Justice Roberts) said:

> "The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined by the law, and is so far in rem that the estate is regarded as *in custodia legis* from the filing of the petition. Acme Harvester Co. v. Beekman Lumber Co., 222 U. S. 300. It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the District Court having acquired the exclusive right to administer all property in the bankrupt's possession. Lazarus v. Prentiss, 234 U. S. 263; White v. Schloerb, 178 U. S. 542; Murphy v. John Hofman Co., 211 U. S. 562; U. S. Fidelity & G. Co. v. Bray, 225 U. S. 205; Hebert v. Crawford, 228 U. S. 204. It may inquire into the validity of liens, marshal them and control their enforcement and liquidation. Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, and authorities cited."

In *Van Huffel* v. *Harkelrode*, 284 U. S. 225 (1931), after a sale, free from liens, had been ordered by a Bankruptcy Court, a County Treasurer, who had received

notice of the application to sell and in response had mailed a statement of the taxes due, asserted a lien on the property for unpaid taxes accrued prior to bankruptcy. The purchaser then sued in a State Court for a decree confirming this title and on refusal of such decree, this Court granted certiorari. The State insisted that the decree of the Bankruptcy Court was invalid because that Court lacked jurisdiction to sell the property free of the State's tax lien, even though the lien was transferred to the proceeds of sale. In sustaining the decree, even though the Bankruptcy Act, at that time, did not expressly confer power to sell free from liens, this Court held that such power was implied, stating:

> "No good reason is suggested why liens for state taxes should be deemed to have been excluded from the scope of this general power to sell free from encumbrances. Section 64 of the Bankruptcy Act grants to the court express authority to determine 'the amount or legality' of any tax. To transfer the lien from the property to the proceeds of its sale is the exercise of a lesser power; and legislation conferring it is obviously constitutional. Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration. Compare International Shoe Co. v. Pinkus, 278 U. S. 261; Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734; Straton v. New, 283 U. S. 318. In many of the cases in the lower federal courts the order of sale entered was broad enough to authorize a sale free from tax liens as well as from others; and in some of them it appears affirmatively that liens for taxes were treated as discharged by the order. No case has been found in which the power to sell free from the lien of state taxes was denied."

In *New York* v. *Irving Trust Company*, 288 U. S. 329 (1933), after a Bankruptcy Court had entered a bar order

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as to "all claims which the State of New York may have against the estate", the State filed a notice of possible demand for taxes accrued prior to bankruptcy and on motion of the trustee the notice was expunged. Certiorari was granted upon the State's complaint that the order expunging its notice was "incompatible with state sovereignty". In dismissing the complaint this Court held:

> "The federal government possesses supreme power in respect of bankruptcies. International Shoe Co. v. Pinkus, 278 U. S. 261, 265. If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

Following the above decisions, the Ninth Circuit in *In re Florence Commercial Co.*, 19 Fed. (2d) 468 (1927), where a County Treasurer, who had seized merchandise to enforce a tax lien, contested the order of the Bankruptcy Court authorizing the sale of the property free from lien and requiring that the County Treasurer establish the validity and amount of his claim against the proceeds, held:

> "Nor are we inclined to the narrow view that, while there may be jurisdiction to determine the amount of the tax, it does not extend to the incidental matter of the tax lien. The bankruptcy court is to see to it that the estate fully discharges all legal obligations in respect of taxes; and accordingly it is invested with power to decide all questions incidental to the performance of that duty."

The pertinent provisions of the Bankruptcy Act relating to the nature and extent of statutory liens asserted in bankruptcy proceedings are contained in sections 67 b and c (11 U. S. C. A. 107 b & c). In connection with those

sections it is necessary to examine Section 64 a (11 U. S. C. A. 104 a). Because of their length we have included them in the annexed Appendix.

The New Jersey statute on which the State relied in filing its claim provided that:

> "These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State" (Rev. 54:19-1).

The alleged lien asserted by the State of New Jersey against the debtor for taxes is in the nature of an inchoate statutory lien.

Two of the leading cases in this court construing statutory liens similar to those created by the tax statutes of the State of New Jersey are: *New York* v. *Maclay*, 288 U. S. 290 and *United States* v. *State of Texas*, 314 U. S. 480.

The *Maclay* case dealt with a franchise tax statute of the State of New York which provided:

> " 'Every such tax or fee (including the annual franchise tax to be paid by corporations) shall be a lien and binding upon the real and personal property of the corporation * * * liable to pay the same until the same is paid in full.' N. Y. Tax Law, Consol. Laws, chap. 60, §197."

Justice Cardozo said, at pages 292, 293 and 294:

> "The lien thus created is effective for many purposes though its amount is undetermined. It is notice to mortgagees or purchasers, who are held to loan or purchase at their own risk if they take their mortgages or deeds before the tax has been assessed or paid. (Citing cases.) * * *
>
> "The problem here is different. To hold that a lien has progressed to such a point as to be a warning

to mortgagees and purchasers of a contingent liability, like a notice of lis pendens, is far from holding that while the liability is unliquidated and unknown the lien thus created is perfect and specific. By the terms of the hypothesis it is nothing of the kind. If the State were to stand upon the warning and omit to ascertain the debt, it would never be able to sell anything, for it would not know how much to sell. Against mortgagees and purchasers a lien perfected afterwards may take effect by relation as of the date of the inchoate lien through which mortgagees and purchasers became chargeable with notice. The doctrine of relation will not divest the United States of the preference that accrued when receivers were appointed."

Justice Cardozo in conclusion said:

"Enough for present purposes that the statutory preference must prevail against the lien of a tax not presently enforceable, but serving merely as a caveat of a more perfect lien to come."

United States v. *Texas, supra,* dealt with a lien arising under a gasoline tax statute of that State which declared that all gasoline taxes due by any distributor to the State "shall be a preferred lien first and prior to any and all other existing liens upon all the property of the distributer devoted to or used in his business as a distributer".

Justice Byrnes, after discussing the *Maclay* case at length, said (pp. 487, 488):

"As to the nature of the proper procedure for levy, seizure, and sale, it is enough to say that some procedure is essential. As we have indicated, the statutory scheme reveals that the legislature contemplated resort to the courts. In addition to the statutory provisions referred to above, Article

7065a-8(e) regulates the pleadings in suits by the Attorney General to collect the tax, and Article 7065a-9 determines the venue of such suits. Consequently, while it was clearly intended by Article 7065a-7 to create a lien in favor of the state, we must conclude that of necessity it was nothing more than an inchoate and general lien. Certainly it did not of its own force divest the taxpayer of either title or possession. It could not become specific until the exact amount of the taxes due had been determined, and it could not be enforced without the assistance of the courts. Like the tax lien in New York v. Maclay, supra, it served 'merely as a caveat of a more perfect lien to come.' ''

In *City of New Orleans* v. *Harrell,* 134 Fed. (2d) 399, (C. C. A. 5th), the City of New Orleans claimed the status of a secured creditor of a bankrupt by reason of an alleged lien for taxes on movables. It asserted a lien prior to a chattel mortgage lien under the Constitution and Laws of Louisiana. The district court held that no such lien existed prior to seizure, and postponed payment of the taxes under Sections 67 b and c of the Bankruptcy Act. Circuit Judge Holmes, in discussing the nature of the lien asserted in the cited case and its postponement in time of payment to the lien of the chattel mortgage, said, page 400:

"Briefly to summarize: The nature and effect of a lien, within the meaning of the Bankruptcy Act, is governed by the law of the state where the bankrupt's property is situated. Prior to said Act of June 22, 1938, statutory liens that were inchoate or incomplete, and had to be perfected by seizure, did not survive in bankruptcy unless the seizure took place before the petition in bankruptcy was filed. Section 67, sub. b of said Act now permits such liens to be perfected by filing notice thereof with the bank-

ruptcy court; this notice was not given in the case before us; but, if it had been, the result would be the same, because by subdivision c thereof the lienor would be placed in a special class of secured creditors whose claims are postponed in payment to the debts specified in clauses (1) and (2) of Section 64, sub. a of said Act."

Judge Hutcheson, in a concurring opinion in the same case, said, page 402:

"Because of Section 67, sub. c, the City of New Orleans must, to prevail, establish more than that it had a statutory tax lien on personal property which arose before bankruptcy and was, therefore, valid both before and under Sec. 67, sub. b. It must establish that before bankruptcy its lien was accompanied by possession of the property, and since it stands admitted that it did not have possession, its claim must fall."

In a subsequent case citing the *Harrell* case, to wit, *City of New York* v. *Hall,* 139 Fed. (2d) 935 (C. C. A. 2nd), Judge Frank in discussing Sections 67 b and c of the Bankruptcy Act, *supra,* said:

"Enough has been done here to bring the City's claims within Section 67, sub. b, 11 U. S. C. A. §107, sub. b. The sole issue is whether they came within Section 67, sub. c, so that they are subordinated to the administration expenses covered by clauses (1) and (2) of Section 64, sub. a, 11 U. S. C. A. §104, sub. a. And that depends on whether the lien was 'accompanied by possession' of the property, which, in turn, depends on the answer to the question whether 'possession', as used in Section 67, sub. c, means merely 'constructive' possession, for obviously there was not actual possession by the City at the time of the filing of the bankruptcy petition.

"The word 'possession' drips with ambiguity. It is not a single purpose word and must be contextually construed. That for some purposes, under some sections of the act, it may include 'constructive' possession gives us no answer to our question. We are convinced that Section 67, sub. c, meant something more. The aim of that amendment is well discussed in 4 Moore's Collier on Bankruptcy (14th Ed.) 163-164: 'As a result of long inaction of tax authorities, liens for taxes which accumulated over a number of years often consumed a bankrupt's entire estate, even to the exclusion of costs and expenses of the bankruptcy proceedings'. The facts here are illustrative: the City's claims are for taxes which had accumulated for seven or eight years respectively. Notwithstanding the admonition of Section 67, sub. c, the City chose to slumber on its rights. Congress intended to penalize such somnolence.

"In Section 67, sub. c, Congress obviously had uniformity in mind. Consequently, New York decisions concerning the effect on other creditors of such action as that, here taken by the City, are not controlling. Whether a lien exists within Section 67, sub. b, is a question of State 'law'. Whether steps taken pursuant to State 'law' are sufficient to constitute 'possession' under 67, sub. c, is a question of Federal 'law'. That conduct must adequately warn potential petitioning creditors of the existence of the lien. The City's action did not satisfy that test."

The application of Sections 67 b and c, *supra,* to real estate and personal property and the assertion of statutory liens as in the case at bar upon such property by a State is dealt with in the case of *In re Pennsylvania Brewing Co.,* 114 Fed. (2d) 1010 (C. C. A. 3rd); cert. den. 312 U. S. 685. In that case, after discussing the contentions

of the appellees regarding statutory liens upon real and personal property, Judge Biggs said:

> "We are of the opinion that Congress has elected to treat personal property and real estate upon different bases. This is clearly one of the purposes of Section 67, sub. c. If there is a statutory lien upon personal property not accompanied by possession or a distress for rent (which is always upon personal property) whether statutory or not, such liens are postponed in payment to expenses of administration and wage claims. If, however, the statutory lien is upon real estate, it is not postponed but is payable strictly pursuant to the provisions of Section 67, sub. b."

Sections 67 b and c and Section 64 of the Bankruptcy Act, were held to be applicable in railroad reorganizations under Section 77 of the Bankruptcy Act in the case of *Lyford* v. *State of New York,* 140 Fed. (2d) 840 (C. C. A. 2nd); cert. den. 323 U. S. 714. In the case cited the State of New York asserted a statutory lien under the Grade Crossing Removal Act of that State in the reorganization of the New York, Ontario & Western Railroad Company, which had filed its petition under Section 77 of the Bankruptcy Act. The State statute provided for a first and paramount lien upon all real property of a railroad corporation. Judge Frank said, at page 845:

> "The State here stresses particularly the new provisions of the Chandler Act amending §67, sub. b, of the Bankruptcy Act, 11 U. S. C. A. §107, sub. b, to the effect that statutory liens for debts owed a state, which are required by state law to be perfected and which arise but are not perfected before bankruptcy, may be valid if perfected thereafter according to state law. The district court held this provision inapplicable because it was not expressly made ap-

plicable to railroad reorganizations as it was to petitions under Chapters X to XIII of the Act, 11 U. S. C. A. §§501 et seq. to 1001 et seq., adding that it would have been easy for Congress to have made the express application had it so desired. But §77, sub. 1, 11 U. S. C. A. §205, sub. 1, states that in railroad reorganization proceedings, 'and consistent with the provisions thereof,' the bankruptcy court's jurisdiction and powers and the rights and liabilities of all persons with respect to the debtor and its property are the same as in ordinary bankruptcy. In Lyford v. City of New York, 2 Cir., 137 F. 2d 782, we made use of this statute to say that §64, sub. a, of the Act, 11 U. S. C. A. §104, sub. a, could be applied, at least by analogy, to §77 reorganizations; and in New York Trust Co. v. Palmer, 2 Cir., 101 F. 2d 1, we held §57, sub. h, not to be inconsistent and hence applicable. Other aspects of §67, sub. b, apart from the perfection clause with which we are now concerned, have been utilized in connection with §77, Board of Directors of St. Francis Levee Dist. v. Kurn, 8 Cir., 98 F. 2d 394, certiorari denied 305 U. S. 647, 59 S. Ct. 153, 83 L. Ed. 418; Thompson v. Glover, 8 Cir., 94 F. 2d 544; In re Erie R. Co., D. C. N. D. Ohio, 37 F. Supp. 237; and Professor Moore strongly urges its applicability, 4 Collier on Bankruptcy, 14th Ed. 1942, 170, 5 id., 1943, 490, 540. On the whole it seems more rational to apply the bankruptcy provisions where they are 'consistent,' and there seems no inconsistencies in the terms of §67, sub. b, as applied to proceedings such as this. Even though the Chandler Act was passed after these proceedings began, the better view, even earlier, was in accord with its principle. See 4 Collier on Bankruptcy 228-230, with extensive citation of cases. It states a reasonable and convenient method of proceeding which we see no reason to disavow here."

At the time of the filing of the petition by the debtor for reorganization nothing had been done by the State of New Jersey to perfect its alleged lien on either real or personal property of the debtor. It was the threat of the Attorney General to enter summary judgment and issue execution that was the immediate cause of the filing of the debtor's petition (*supra*, p. 40).

It is accordingly respectfully submitted:

(1) That the State has never had and cannot now claim a lien on any of the personal property of the debtor, and that

(2) One of the fundamental questions that the Bankruptcy Court and it alone must decide is the nature and extent of the alleged liens of the State and the liens of bondholders on the various classes of property of the debtor.

B

As to the Amount, Priority and Legality of the State's Tax Claims

This Court has repeatedly held that the Bankruptcy Courts have full and complete jurisdiction to determine the amount, priority and legality of the claims of all creditors, including the claim of any State or municipality, and that the Bankruptcy Court will apply the pertinent provisions of the bankruptcy statute.

In *Wragg* v. *Federal Land Bank of New Orleans;* 317 U. S. 325, the late Chief Justice Stone in his opinion said:

> "In the interpretation and application of the Bankruptcy Act as in the case of other federal statutes, federal not local law applies. Prudence Realization Corp. v. Geist, 316 U. S. 89, 95, 86 L. ed. 1293, 1298, 62 S. Ct. 978, and cases cited. It is for the bank-

> ruptcy court to determine, by reference to the provisions of the bankruptcy statute, what rights created by state law—regardless of the characterization which may be applied to them by state statutes and decisions—are within the jurisdiction of the bankruptcy court. United States v. Pelzer, 312 U. S. 399, 402, 403, 85 L. ed. 913, 915, 916, 61 S. Ct. 659."

As this Court recently made clear in *Pepper* v. *Litton*, 308 U. S. 295; *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, and *Heiser* v. *Woodruff*, 66 Sup. Ct. 853, courts of bankruptcy are essentially courts of equity and where necessary to avoid inequitable results will apply federal rather than local law.* As the late Chief Justice Stone said in *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64 is inapplicable

> "to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than local law."

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* In *American Propeller & Mfg. Co.* v. *United States*, 300 U. S. 475, it was said:

> "When the United States comes into court to assert a claim, it so far takes the position of a private suitor as to agree by implication that justice may be done with regard to the subject matter."

It would seem that under this rule, since the Attorney General has delayed a decision as to the amount of the State's claims since September 4, 1941, by filing the civil information suit in the State Courts; by his appeal from Order No. 163 after failing to appeal from Order No. 135; by his special appearance filed August 22, 1944; his appeal from Order No. 271 and his petition for a writ of prohibition to the Circuit Court, it would be most unjust and inequitable in any event to allow the State to recover penalties of 1% per month as a preferred claim or lien.

Even before the Bankruptcy Act in the 1938 amendment specifically provided that the tax claims of a State must be filed and that a State which did not file its claim in the Bankruptcy Court might be barred (Section 57n, 11 U. S. C. A. 93(n)), it was the settled law that bankruptcy courts, as part of their inherent power, had jurisdiction to ascertain the validity, amount and priority of all liens, including the tax liens of a State, and that if a State in a bankruptcy proceeding did not appear, it incurred the risk that its tax claim, even though secured by a lien, might be forever barred.

Under the provisions of Section 77 of the Bankruptcy Act, Congress expressly conferred on Bankruptcy Courts handling railroad reorganization proceedings the jurisdiction that this Court had previously held was inherent in courts handling ordinary bankruptcy proceedings.

Thus Section 77, after providing the following definitions in subsection (b):

> "The term 'creditors' shall include, for all purposes of this section, all holders of claims of whatever character against the Debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act",

and

> "The term 'claims' includes debts, whether liquidated or unliquidated, securities, liens, or other interests of whatever character",

provides in subsection c (7) that:

> "The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown".

Section 77 also provides in subsection (1) that:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the Court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Finally, Section 77, in subsection (f) provides that upon confirmation by the judge any plan of reorganization shall

> "be binding upon * * * all creditors, secured or unsecured, whether or not adversely affected by the plan and whether or not their claims shall have been filed, and if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it".

And that the plan may be carried out

> "the laws of any State or the decision or order of any State authority to the contrary notwithstanding".

And that upon confirmation of the plan

> "the property dealt with by the plan * * * shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan".

Shortly after Section 77 was enacted, the Trustee of a railroad in reorganization under that section was sued in a State Court on the ground that the title of part of the railroad property, of which the trustee had taken possession, had been forfeited, and in passing on the juris-

dictional question that resulted, this Court in a unanimous opinion by Mr. Justice Brandeis, in *Ex Parte Baldwin*, 291 U. S. 610 (1934), announced:

> "All property in the possession of a bankrupt, of which he claims the ownership passes, upon the filing of a petition in bankruptcy, into the custody of the Court of Bankruptcy * * *. Having possession, the Court may not only issue all writs necessary to protect its possession from physical interference, but is entitled to determine all questions respecting the same (citations)."

And further, that the exclusive jurisdiction of the Bankruptcy Court "was not limited to the prevention of interference with the use of the land" but extended "to the adjudication of questions respecting the title".

A year later this Court, in *Continental Illinois National Bank and Trust Co.* v. *C. R. I. & P. Railway Co.*, 294 U. S. 648 (1935), was confronted with the question whether an order entered by a Bankruptcy Court under Section 77, restraining secured creditors (who were not parties to the proceeding and had not been served with process but had been given notice of the hearing on which the decree was entered), from selling certain securities of the debtor railroad which they owned, was authorized by Section 77, and if so, whether said section was constitutional. In sustaining the validity of the order and the constitutionality of the Act, this Court, in the opinion of Mr. Justice Sutherland, said:

> "Section 77 advances another step in the direction of liberalizing the law on the subject of bankruptcies. Railway corporations had been definitely excluded from the operation of the law in 1910 (C. 412, Section 4, 36 Stat. 838-839) probably because such corporations could not be liquidated in the ordinary way or by a distribution of assets. A railway is a unit; it cannot be divided up and disposed of piece-meal like

> a stock of goods. It must be sold, if sold at all, as a unit and as a going concern. Its activities cannot be halted because its continuous, uninterrupted operation is necessary in the public interest; and for the preservation of that interest, as well as for the protection of the various private interests involved, reorganization was evidently regarded as the most feasible solution whenever the corporation had become 'insolvent or unable to meet its debts as they mature'" (671, 672).

And in holding that even creditors, who were not parties to the reorganization proceeding, were nonetheless subject to the decree of the Bankruptcy Court, this Court quoted with approval the following language from *Canada Southern Railway Co.* v. *Gebhard*, 109 U. S. 527:

> "Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail."

And finally, by way of emphasizing that the jurisdiction of bankruptcy courts over railroad property in reorganization under Section 77 was in certain respects even broader than the ordinary jurisdiction of a bankruptcy court, the opinion stated:

> "It may be that in an ordinary bankruptcy proceeding the issue of an injunction in the circumstances here presented would not be sustained. As to that it is not necessary to express an opinion. But a proceeding under Section 77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised. And to prevent the attainment of that object is to defeat the very end the accomplishment of which was the sole aim of the section, and thereby to render its provisions futile."

Subsequently, in *Board of Directors St. Francis Levee District* v. *Kurn*, 91 Fed. (2d) 118 (C. C. A. 8th, 1937), cert. den. 302 U. S. 750, the question was squarely presented whether a bankruptcy court in a reorganization proceeding under Section 77 had jurisdiction to restrain a proceeding by a State agency (which was not a party to the reorganization proceeding) to enforce in a State Court the collection of taxes on land of the debtor railroad. In sustaining the jurisdiction of the Bankruptcy Court, the Eighth Circuit Court of Appeals held that Section 77

> "in plain terms, authorized the Court to enjoin judicial proceedings to enforce any lien upon the property"

And added:

> "Although the Arkansas statutes contemplate that the only method to enforce collection of the levee taxes is by suits in the Chancery courts of the State, such as have been brought by the levee district, the power of the bankruptcy court to determine all questions respecting the property in its possession is paramount. 'Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration.' Van Huffel v. Harkelrode, 284 U. S. 225. The question of the amount and validity of the levee tax lien must be submitted to the bankruptcy court and settled by it. Ex Parte Baldwin, 291 U. S. 610; In re Tyler, 149 U. S. 164."

Finally, in *Lyford* v. *City of New York*, 137 Fed. (2d) 782 (C. C. A. 2nd, 1943), the question was presented whether the decree of a bankruptcy court adjudicating the amount and legality of the taxes levied against a railroad in reorganization under Section 77 was valid, and in sustaining the decree, the Second Circuit Court of Appeals, after noting that this Court in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, had left

open the question whether Section 64a applies to railroads in reorganization, held that since Section 64a was entirely consistent with Section 77 its terms were applicable, and then added:

> "Moreover, we do not see that our problem would be greatly changed, however our conclusion is expressed as to this point. If there was no provision expressly dealing with the power to adjudicate tax claims, the court would still have to find that such a claim was legally due; its general power to pass upon claims would require no less. See In re 168 Adams Bldg. Corp., supra; Pepper v. Litton, 308 U. S. 295, 303, 304. Thus section 77 itself provides that the judge 'shall promptly determine' the manner in which claims of creditors 'may be filed or evidenced and allowed,' sub. c (7), and may refer such matters to a special master, as was done here, sub. c. (13). And there seems no reason why the general bankruptcy provision as to allowance of claims by the court, section 57, sub. d, should not apply. See New York Trust Co. v. Palmer, supra; Guaranty Trust Co. of New York, v. Henwood, 86 F. 2d 347; cert. den. 300 U. S. 661; In re Erie R. Co., 133 F. 2d 730; In re D. & R. G. W. R. Co., 27 F. Supp. 983; Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago R. I. & P. R. Co., 294 U. S. 648, 675-678; cf. however, In re C., M., St. P. & P. R. Co., 27 F. Supp. 685."

The Special Master in the case at bar, in his Interim Report (R. 39), said:

> "In the opinion of the Master, the entire property of the railroad is *in custodia legis*, subject, however, to such rights as are given by law to lien-holders. The cases cited by the Attorney General do not hold otherwise. Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in

the case of Arkansas Corporation Commission v. Thompson, 313 U. S., p. 132, supra, *which limitation is not now involved*, is the proper Court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court. Isaacs v. Hobbs Tie & T. Co., 282 U. S., p. 734, at p. 738."

The essential point decided by this Court in *Arkansas Corporation Commission et al.* v. *Thompson, supra*, was well summarized in the opinion of Judge Clark in *Lyford* v. *City of New York, supra*, as follows:

> "• • • The effect of the Thompson case is, • • • to deny it (the Bankruptcy Court) power to review the action of a quasi judicial taxing body in setting, after due hearing, a valuation of property for tax purposes." (Parentheses supplied.) (p. 786)

However, the Circuit Court of Appeals in the case at bar in its opinion said:

> "The case of Arkansas Corporation Commission et al. v. Thompson, 313 U. S. 132, is directly in point" (R. 160).

Thus, the opinion of the Third Circuit Court of Appeals in the present case discloses that that court erroneously assumed that the primary issue as to which the Bankruptcy Court had assumed jurisdiction in this case was the amount of the assessed valuations of the debtor's property.

We have tried to make it crystal clear in the Statement of Facts that this case in no way involves any question as to the assessed valuation of the debtor's property. As a matter of fact, in this case the debtor had taken appeals from the assessment of taxes for each year through

the State Board of Tax Appeals, and as it was defeated there it had filed original bills in the United States District Court attacking the assessments as confirmed by the State Board of Tax Appeals on various constitutional grounds, which are well stated by Judge Forman in *Central Railroad Company of N. J.* v. *Martin, supra,* which determined that the taxes had been assessed in plain violation of established principles that govern property valuation.*

It was while the assessments and tax rates made by the State were being contested for the years 1937 to 1941 inclusive in the very manner held necessary by the opinion of Mr. Justice Black in the *Arkansas* case, *supra,* that the State passed the Railroad Tax Settlement Act of 1941 and held out its solemn offer of compromise to the trustees of the debtor and all other railroads in reorganization and in default which was accepted by the trustees with court approval.

There can be no doubt in this case that the trustees fully complied with their duty as stated in the *Arkansas* case, *supra.* The question here presented is entirely different. It is novel; for never before has a State by public

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* The justification for the debtor to appeal to the United States District Court for relief from illegal New Jersey taxes on the ground of the denial of the equal protection of the laws and of due process of law is shown by the decision of this Court (Mr. Justice Douglas) in *Township of Hillsborough* v. *Doris Duke Cromwell,* decided Jan. 26, 1946, 326 U. S. 620. See also *Greene* v. *Louisville & Nashville R. R. Co.,* 244 U. S. 499, 518-519; *C. R. R. Co. of N. J.* v. *Martin,* 65 F. (2d) 613; and *C. R. R. Co.* v. *Jersey City,* 199 Fed. 237, 243.

The debtor's ground of complaint as to the excessiveness of the average tax rate which was employed in fixing the tax levies for the years 1932 to 1940, inclusive, R. 73, 74, 85, 86, was waived by the trustees as one of the conditions necessary for the acceptance by them of the compromise offered by the Tax Settlement Acts hereinafter mentioned.

laws made to a Bankruptcy Court an offer of compromise of vast taxes and penalties thereon, and after the acceptance of such an offer by the court and its trustees attempted to repudiate such offer and at the same time retain the benefits it had received by such acceptance, to wit: the discontinuance of all pending appeals properly taken under State law in the manner indicated as necessary in the *Arkansas* decision of this Court, and the termination of all litigation with respect to such taxes.

We submit it is thoroughly established that the Bankruptcy Court has sole jurisdiction in the present case to pass upon the amount, if any, now due to the State on its claim filed in the debtor's proceedings for taxes in arrears and the interest and penalties thereon. This involves, at the very threshold, passing upon the validity of the compromise made by the trustees on court order under the provisions of the Settlement Acts.

It will be impossible for the Commission or anyone else to prepare any plan of reorganization of this debtor, under Sec. 77, until the Bankruptcy Court exercises this jurisdiction and determines the questions herein presented.

POINT III

The compromise between the State and debtor's Trustees arising from the acceptance of the provisions of the Tax Settlement Acts is valid and enforceable (A) under Section 27 of the Bankruptcy Act; as well as (B) under New Jersey law.

(A) Under Section 27 of the Bankruptcy Act

Section 27 of the Bankruptcy Act of 1898 (U. S. C. A., Tit. 11, Sec. 50) provides:

> "The trustee may with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."

The term "any controversy" is broad enough to include controversies with municipalities, states and the federal government, as well as claims of individuals.

General Order No. 33 promulgated by this court provides:

> "Whenever a receiver, trustee or debtor in possession shall make application to the court for authority to submit to arbitration any controversy arising in the settlement of an estate, or for authority to compromise any such controversy, the application shall clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interests of the estate that the controversy should be settled by arbitration or compromise" 11 U. S. C. A., Sec. 53, p. 86.

There is ample judicial precedent for the action of the District Court in authorizing its trustees to accept the

offer of the State contained in the Tax Settlement Acts. Not only does the Court of Bankruptcy possess the power of a court of equity to settle controversies between the trustee and creditors or claimants, but there is express statutory authority which empowers the court to approve such settlements when "for the best interests of the estate".

Pullman Couch Co. v. *Eshelman* (4th Cir.), 1 Fed. (2d) 885;
Drexel v. *Loomis* (8th Cir.), 35 Fed. (2d) 800;
In re Riggi Bros. (2nd Cir.), 42 Fed. (2d) 174;
In re Van Camp Products Co. (C. C. A. 7th Cir.), 95 Fed. (2d) 206;
In re Prudence Co. (C. C. A. 2nd Cir.), 98 Fed. Rep. (2d) 559;
In re Kansas City Journal-Post Co. (C. C. A. 8th Cir.), 144 Fed. (2d) 816.

All of the above cases involve appeals from the order approving the settlement. In cases where the offeror has declined to go through with the settlement after approval, it has been held that the court has power by summary order to hold him to the performance of the compromise on the ground that by making his offer he has subjected himself to the jurisdiction of the court so far as the compromise is concerned.

In re Sobod Inc., 25 Fed. Supp. 344; aff'd. 103 Fed. (2d) 1096;
In re Hollingsworth & Whitney Co. (1st Cir.), 242 Fed. 753.

The case of a judicial sale is a fair analogy. A court which has ordered a sale of property in its care may order a defaulting purchaser to carry out the bargain he made.

Camden v. *Mayhew*, 129 U. S. 73;
In re Rival Knitting Co. (2nd Cir.), 289 Fed. 960.

Certainly there is no reason for having a different rule where the State is claimant in the Bankruptcy proceedings. In the case at bar the offer of compromise was made by the Legislature with the Governor's approval, which is the most solemn form of offer of compromise that a State could make. Moreover the State prior to the passage of the Tax Settlement Acts had entered the proceedings as a creditor and its verified claim was before the court for allowance and adjudication.

The Attorney General did not commence the information suit to attack the constitutionality of the Railroad Settlement Act of 1941 until after the court had made its order directing the trustees to accept the State's offer of compromise and the trustees had filed with the proper state officers their undertaking in writing to pay the principal of the defaulted taxes with 3% interest, and had also delivered the necessary discontinuances of pending actions and the certified checks, as required by the Statute. Furthermore, after the Attorney General in the Fall of 1941 filed his information suit, the next, or 1942 Legislature passed a law amending the 1941 Tax Settlement Act for the very purpose of curing any technical defects therein, and prescribing the exact form of undertakings and acceptance papers to be delivered, and eliminated the requirement that such papers be approved by the Attorney General.

Two successive Legislatures having passed Railroad Tax Settlement Acts which were approved by the Governor, the provisions of both of which laws were accepted by the trustees with court approval, there can be no doubt of the intention of the State to offer a compromise of the tax claims or of the acceptance thereof by the trustees with full and complete court approval. The only objector to this compromise is the Attorney General, whose duty in the premises is expressed in Paragraph 9 of both Settlement Acts, as follows:

"The Attorney General is hereby authorized *and directed* to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act" (as amended by Section 9 of the 1942 Act).

(B) The Compromise is valid and enforceab.e under New Jersey Law.

The Railroad Tax Settlement Act of 1941 contains this provision:

"12. Effect of Unconstitutionality.

If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of this Act, or application of such provision to other persons or circumstances, shall not be affected thereby."

The same provision was contained in Sec. 15 of the Amendment of 1942.

Since, under New Jersey law,

"A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who has admitted the existence of a state of facts that in the opinion of the court renders the law unconstitutional" (Pitney, J., in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475),

it follows that the separability clauses in the Tax Settlement Acts will operate to preserve to debtor's estate the benefits of said Acts.

40 Harvard Law Review, 626;
51 Harvard Law Review, 76.

Under the decisions of the New Jersey Court of Errors and Appeals, a duly enacted statute is not null and void, even though later declared unconstitutional, and actions taken in good faith under the statute are effective, certainly when taken prior to any challenge. *Allison* v. *Corker*, 67 N. J. L. 596; *Attorney General* v. *McGuinness*, 78 N. J. L. 346; *Eastwood* v. *Russell*, 81 N. J. L. 672; *In re Public Utility Board*, 83 N. J. L. 303, (1912).

In *Allison* v. *Corker, supra,* a statute, later declared unconstitutional, was accepted and acted upon. Subsequently it was amended and supplemented by an admittedly valid Act which corrected the original defect. The question was whether the supplemental Act cured the vice in the original Act and thus supported the acts already taken in reliance thereon. The Court of Errors and Appeals held the statute valid and effective. In so holding, the Court said (pp. 600-601):

> "But I am prepared to go further and hold that an unconstitutional statute is nevertheless a statute—that is, a legislative act * * *. The function of the judicial department, with respect to legislation deemed unconstitutional, is not exercised *in rem*, but always *in personam*. The Supreme Court cannot set aside a statute as it can a municipal ordinance. It simply ignores statutes deemed unconstitutional. For many purposes an unconstitutional statute may influence judicial judgment, where, for example, under color of it, private or public action has been taken. An unconstitutional statute is not merely blank paper. The solemn act of the legislature is a fact to be reckoned with. Nowhere has power been vested to expunge it or remove it from its proper place among statutes."

In *In re Public Utility Board, supra,* the Court said:

> "An act of the legislature, duly passed by both houses and approved by the governor, is presumably

a valid statute; and even though violative of some constitutional provision, it is not therefore null and void *ab initio*. As was said by Chief Justice Butler in *State* v. *Carroll*, 38 Conn. 449: 'Every law of the legislature, however repugnant to the constitution, has not only the appearance and semblance of authority but the force of law. It cannot be questioned at the bar of private judgment, and, if thought unconstitutional, resisted, but must be received and obeyed as, to all intents and purposes, law, until questioned and set aside by the courts. This principle is essential to the very existence of order in society.' The soundness of this doctrine is not in doubt in this state" (p. 306).

In *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371, this Court overruled its earlier decision in the *Shelby County* case and said (Chief Justice Hughes):

> "The actual existence of a statute, prior to such a determination (of unconstitutionality) is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to be considered in various aspects—with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights claimed to have become vested, of status, of prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination."

See also *Phipps* v. *School District of Pittsburgh*, (C. C. A. 3d) 111 Fed. (2d) 393; *J. A. Dougherty's Sons* v. *Commissioner of Int. Rev.* (C. C. A. 3d) 121 Fed. (2d) 700.

In the New Jersey cases cited the action taken was before any challenge had been made. In *Attorney General* v. *McGuinness, supra,* the Court of Errors and Appeals indicated that the existence of a bare challenge does not vary the local New Jersey rule. In that case it said:

> "For such mistaken conception leads to the radical error that, if duly challenged, a legislative act will be sustained only when it is demonstrably constitutional. Such a notion in effect supplements the constitution by requiring the affirmative concurrence of all three departments of the government where that instrument of the organic law requires but two, viz., the legislative and the executive * * *."

The debtor's relinquishment of all further rights to contest in the State tribunals, whether by express waiver or by allowing time to lapse, was first made under authority of Order No. 123 responsive to the 1941 Settlement Act, at a time when no challenge and no notice of any contemplated challenge had occurred. The 1942 Act was amendatory of and supplemental to the 1941 Act, and Order No. 163, responsive to the 1942 Act, was necessary to preserve a change in status already made in reliance upon the earlier Act. Such a state of affairs justified, if, indeed, it did not require, the Bankruptcy Court to order compliance upon the principle that the legislative offer was the law of the state until declared unconstitutional. [See Order 163, R. 285, par. 5.]

Moreover, this Court has now held that a District Court, having the necessary jurisdiction over the parties and acting in the exercise of its equity powers, may determine the local law where, due to the situation existing, it is appropriate for it to do so. *Meredith et al.* v. *City of Winter Haven,* 320 U. S. 228. In the *Winter Haven* case, jurisdiction rested upon diversity of citizenship, while here it rests on the Bankruptcy Act. There the

circumstance which made a determination essential was the confusion existing in the decisions of the State Courts. Here the situation made a determination even more imperative, for the State decisions on the effectiveness of a statute even though later declared unconstitutional were clear, immediate action was necessary, and there was no dispute as to the meaning of the statute.

The concluding paragraph of the opinion of this Court in the *Winter Haven* case is apposite here:

> "Even though our decisions could not finally settle the questions of state law involved, they did adjudicate the rights of the parties with the aid of such light as was afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law. In this case, as in those, it being within the jurisdiction conferred on the federal courts by Congress, we think the plaintiffs, petitioners here, were entitled to have such an adjudication."

Wilentz v. *Hendrickson*, (*supra*) was decided on a stipulation of facts made between the State's Attorney General and Treasurer. The Court of Errors and Appeals held that the Tax Settlement Acts amounted to an appropriation of money to corporations in violation of Art. I, par. 20 of the State Constitution.

In reaching its conclusion the Court said (at p. 253):

> "Thus if the state has a vested right in and to the tax debt (delinquent interest), then unless the remission, cancellation and abatement of that right is supported by a 'legal, equitable or moral consideration' (In re Voorhees, 123 N. J. Eq., 142) the challenged statutes clearly contravene, in spirit and in fact, the Constitutional limitation (Art. I, par. 20) invoked."

Again, at page 260, the Court said,

"Nor do we find anything in the proofs to support a moral or equitable consideration."*

A trifling inconvenience to the one party or a slight advantage to the other is sufficient to constitute lawful consideration. *National Bank* v. *Bloom*, 113 N. J. L. 597, 602 (E. & A.). " 'Consideration' in the legal sense of the word, of a contract is the quid pro quo, that which the party to whom a promise is made does or agrees to do in exchange for the promise." *Phoenix Mutual Life Insurance Company* v. *Raddin*, 120 U. S. 183.

Restatement of the law of Contracts, Vol. I, Sec. 75 states:

"DEFINITION OF CONSIDERATION.

(1) Consideration for a promise is

(a) an act other than a promise, or
(b) a forbearance, or
(c) the creation, modification or destruction of a legal relation, or
(d) a return promise,
bargained for and given in exchange for the promise.

(2) Consideration may be given to the promisor or to some other person. It may be given by the promisee or by some other person."

At the time the Trustees on Court approval accepted the provisions of the Railroad Tax Settlement Acts and filed with the proper State Officers their undertaking to pay the taxes in arrears in the manner provided by the

* The Vice Chancellor in *Wilentz* v. *Hendrickson*, 133 N. J. Eq. at p. 483, stated that the debtor "is offered an abatement of $7,555,531.97 * * * as contrasted with potential savings on its then pending tax appeals of $5,951,395.86." The trustees discontinued such appeals in accepting the Settlement Acts.

Acts, and delivered to the State Treasurer their certified checks for the amounts due under the Acts, together with consents to the discontinuance of all pending appeals from assessment of taxes, it was the settled law in New Jersey that taxes and penalties in arrears due to the State might be compromised and also that the interest of 1% per month was a penalty and not a part of the tax.*

Town of Belvidere v. *Warren Railroad Co.*, 34 N. J. L. 193;
Dixon v. *Jersey City*, 37 N. J. L. 39;
Camden v. *Allen*, 26 N. J. L. 398;
Pennsylvania T. & T. Co. v. *Gummere*, 87 N. J. L. 353.

See also the powerful dissenting opinion of Justice Case in *Wilentz* v. *Hendrickson*, 135 N. J. Eq., at page 275.

It is, therefore, respectfully submitted (a) that *Wilentz* v. *Hendrickson* (*supra*) having been tried on an agreed state of facts is under New Jersey law binding only upon the parties to the information suit, namely, the Attorney General and the State Treasurer; (b) even under that decision, where legal, equitable or moral consideration supports the settlement between a taxpayer and the State it is valid and binding on the State; (c) under the Separability Clause in the Statute, the rights of any taxpayer entitled to the benefits of the Settlement Acts are fully preserved; and finally (d) the debtor and its trustees having given legal, equitable and moral consideration for their acceptance of the terms of the Settlement Acts are entitled to the benefits thereof under State law as well as under Section 27 of the Bankruptcy Act, 11 U. S. C. A. 50.

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* The State decisions after 1943 hold that the interest of 1% per month is not a penalty and becomes a part of the tax debt.

Wilentz v. *Hendrickson*, 135 N. J. E. 244 (1944);
State v. *Erie R. Co., et al.*, 23 N. J. Misc. 203 (1945).

The discussion under this point is presented to make clear to this Court the intricacies of the problems presented by the Trustee's petition for adjudication; to present the status of the Federal and New Jersey law; and to indicate that the issues involved are not *res adjudicata* under *Wilentz* v. *Hendrickson*, but must be determined under Federal Law.

POINT IV

There is a substantial question for decision as to whether the State has lost its alleged lien (A) By demanding and accepting payments on account out of Debtor's General Funds; (B) By repealing the statute which gave a lien and at the same time enacting a new law which attempts to preserve, change and extend the alleged lien; and (C) By accepting payments equal to the principal of taxes in default plus 3% interest from December 1, 1940 which, under the terms of the Settlement Act, discharged the lien.

A

We have shown in the statement of facts, pages 8 and 9 hereof, how the Attorney General several times appeared generally in the bankruptcy proceedings and requested payments on account of the taxes in arrears. The claim of the State of New Jersey asserted in paragraph 10 (R. 66):

> "The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

Payments made by the debtor and Trustees to the State prior to the filing of the State's proof of claim appear under the item of collection in the schedule annexed to the proof of claim (R. 68-69).

Payments on account made after the proof of claim was verified, December 15, 1940, are shown, *supra*, at page 35.

The last payment of $15,250,000 was made May 6, 1946 (R. 318), pursuant to Order 333, dated April 26, 1946, consented to by the Attorney General (R. 296).

The total paid the State on account of its tax claims for the years 1932-1939 inclusive by the debtor and the trustees since bankruptcy aggregates $18,199,553. It is believed by the trustee that it will be ultimately determined that this amount is sufficient to have paid the State in full the principal amount of its taxes to December 1, 1940, and 3% interest thereon from December 1, 1940 to the date of payment in accordance with the provisions of the Railroad Tax Settlement Act.

While the State in its proof of claim made reference to its lien, this was required by Section 57 (c) of the Bankruptcy Act, 11 U. S. C. A. 93(c). There is no suggestion that the State intended to rely solely upon its lien. On the contrary, all of the indications were that the State deliberately chose not to rely on ultimate enforcement of its alleged lien but rather to secure with the aid of the Bankruptcy Court prompt payment by installments long ahead of the debtor's reorganization.

When the debtor filed its petition under Section 77 of the Bankruptcy Act, 11 U. S. C. A. 205, the State was confronted by a choice of remedies, and these remedies were inconsistent. If the State chose to rely primarily upon its alleged security it would have the burden of proving the validity and amount of its lien, and before realizing any tax money would have to wait until its alleged security was valued and any deficiency payable out of general assets was determined. On the other hand, if the State

wished to begin promptly collecting part of the disputed taxes it might waive its lien and file a proof of claim for the full amount of taxes and penalties *claimed*, shifting to the debtor's estate the burden of showing that the full amount claimed was not due. Confronted by these inconsistent remedies the State chose the latter (a) by filing its proof of claim *for the full amount of the taxes and penalties claimed* and (b) by requesting and accepting cash payments on account aggregating over $18,000,000 out of assets on which the First Mortgage Bondholders claimed to have a first lien.

Commenting on such a choice of remedies by a secured creditor, the Seventh Circuit Court, in *In re O'Gara Coal Co.*, 12 Fed. (2d) 426 (C. C. A. 7th; cert. den. 271 U. S. 683), said:

> "When one has two inconsistent remedies and elects to pursue one, he abandons the other. The remedies open to the receiver in this case were wholly inconsistent, and were to be secured by different lines of procedure. In the case of the proceeding as for an unsecured claim, the participation would be, as between the receiver and other creditors, upon the full amount of the claim. If the procedure was by the course to establish the balance of a secured claim, the participation would be only upon that balance. In bankruptcy, there have been many decisions in the District Courts, all to the effect, so far as we have found, that the consequence of filing a secured claim as an unsecured debt is the waiver of the security. *White* v. *Crawford* (C. C.), 9 F. 371; *In re M. I. Hibbler Machine Co.* (D. C.), 192 F. 741; *In re Fisk & Robinson* (D. C.), 185 F. 974; *In re Little* (D. C.), 110 F. 621, 627 (Judge Shiras); *In re Notris*, 18 Fed. Cas., page 316, No. 10,303; *In re High*, 12 Fed. Cas., page 133, No. 6,473; *In re Jaycox*, 13 Fed. Cas., page 409, No. 7,242; in which case it was held, however, that when such proof was made through ignorance or

mistake a creditor ought to be allowed to withdraw his proof and prove as a secured creditor; *In re Granger*, 10 Fed. Cas., page 958, No. 5,684."

To the same effect, see *In re Stineman*, 155 Fed. (2) 755 (certiorari granted October 14, 1946, No. 371, October Term), where the Third Circuit Court of Appeals recently held that creditors who had filed claims based upon judgment liens and then had accepted dividends out of general assets must be held to have waived their security because

"It is fundamental that the value of securities held by creditors must be valued before they may participate in distributions from the general estate and dividends may be paid only on the unpaid balances."

And the Court in applying the rule added that since the lien creditors

"have received dividends from the general estate to the full extent of their claims as allowed without having the value of their securities ascertained or deducted as provided by law* they must be deemed to have elected to be treated as general creditors and to have waived their rights to the security of their judgment liens. See *In re O'Gara*, 12 F. 2d 426, cert. den. 271 U. S. 683, and the cases cited therein; *Coggin* v. *Hartford Accident & Indemnity Co.*, 9 F. Supp. 785."

See also *Fisk & Robinson*, 185 Fed. 974; *Robinson* v. *Exchange National Bank of Tulsa*, 28 Fed. Supp. 244 (D. C. Okla., 1939); and *Butler* v. *Commonwealth Tobacco Co.*, 74 N. J. E. 423. In the latter case the New Jersey Court of Errors and Appeals, in an opinion contrasting

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* Sections 57h and 65a of the Bankruptcy Act, 11 U. S. C. A. 93(h) and 105(a).

the so-called bankruptcy rule with the equity rule, pointed out that the New Jersey Courts in both bankruptcy and insolvency cases have followed the "bankruptcy rule" consistently since 1835. In other words, for over 100 years the established rule in New Jersey has been that a secured creditor claiming against an insolvent debtor must either "waive his security and prove for the full amount of his debt or evaluate his security and prove for the difference."

In view of the above principles and precedents, it is submitted *first*, that the moving party in the present proceeding was the State itself, which invoked the jurisdiction of the Bankruptcy Court by filing its Proof of Claim; *second*, that no issue respecting the State's alleged lien has, as yet, been submitted to the Bankruptcy Court (except in the Trustee's petition for adjudication of August 14, 1944) and if any question respecting said lien should hereafter arise, it will be merely incidental to the State's tax claims which are now at issue (*Coder* v. *Arts*, 213 U. S. 223); and *third*, since the State elected to file its claim for the full amount alleged to be due, instead of for any deficiency over and above the value of its alleged lien, and has accepted large payments out of general assets on account of said claim, it has waived any lien it might have relied upon.

B

The State's Proof of Claim for taxes asserts a lien under par. 10, Sec. 9, Ch. 208, P. L. 1888, as amended and supplemented; Sec. 54:27-4, Revised Statutes, N. J.

This section of the statute, which was a part of the Railroad Tax Act, provides:

"54:27-4. Default; penalty; remedies; liens.

"If the taxes of any company, or any part thereof, remain unpaid on December 1st following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one percent for each month until paid. Notwithstanding the prosecution of a writ of certiorari or other remedy the taxes shall be a lien paramount to all other liens upon *all the lands and tangible property and franchises of the company in this State.* The liens shall take effect on *June 1st* of the year in which the tax is payable and shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this Title (Sec. 54:19-1, et seq.)."

The above section was repealed by Section 75, Chapter 291, P. L. 1941* (Rev. 54:29A-75 (Pamphlet)), (New Tax Act).

The New Tax Act contains the following provisions:

"54:29A-53. Interest. Taxes heretofore imposed pursuant to any law for the taxation of property used for railroad and canal purposes, or hereafter imposed pursuant to this Act, or any unpaid portion thereof, shall bear interest from and after the date upon which they became or may become due and delinquent at the rate of one percentum (1%) for each month until paid notwithstanding the prosecution of a writ of certiorari or other remedy."

"54:29A-54. Lien of Taxes. The taxes imposed by this Act or heretofore imposed pursuant to any act for the taxation of property used for railroad and

* A copy is in the Appendix annexed.

canal purposes, shall be and remain a lien paramount to all other liens *upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State.* The lien shall take effect as of the *1st day of the year* in which the tax is payable."

"54:29A-55. Tax a debt; preference. The taxes imposed by this Act or heretofore imposed shall be and remain a debt due from the taxpayer to the State for which an action at law or suit in equity may be maintained and shall be a preferred debt in case of insolvency."

A comparison of the old and the new sections of the Tax Laws shows an attempt to extend the lien of the State to assets of the debtor and other railroads that were not covered by the old law. The State now contends that its lien extends to "the *revenues* of the debtor", and to "personal property *controlled* by the debtor", assets which were not subject to the State's alleged lien prior to 1941.

We know of no authority for a creditor, whether it be a State or mortgagee, to change and extend a lien on a bankrupt's property after a petition in bankruptcy has been filed. Upon the filing of the petition in bankruptcy the rights of the bankrupt, or debtor, creditors and stockholders, became fixed.

Straton v. *New*, 283 U. S. 318.

What happened to the lien asserted by the State under the old law, in existence when the petition was filed by the debtor, when the State passed the 1941 Tax Act, Chap. 291 which in Section 75 expressly repealed the former law under which the taxes in question were assessed and the liens created?

Were such liens effectually preserved by Section 74, Chap. 291* of the repealing act, which stated:

> "Nothing herein shall be construed to * * * repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed * * * or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act, or under any other law, *except as specifically provided in this act.*"

It would seem that the purpose of the last clause was to hold the old lien and yet extend it to cover assets not covered by the original lien.

We have no doubt that if a mortgagee, after a petition in bankruptcy had been filed against an individual or corporate debtor, had cancelled his mortgage and simultaneously had taken and recorded from the bankrupt a new mortgage covering property in addition to that covered by the original mortgage, it would be held that the lien of the cancelled mortgage was extinguished even though the new mortgage contained the provision that it "shall be and remain a lien paramount to all other liens" on the property of the bankrupt. We know of no authority sustaining the right of a State to alter and extend its lien after a Court of Bankruptcy had obtained jurisdiction by repealing the old and enacting a new law in the manner indicated.

It would seem that, with all the facts considered, the State has elected to rely on its claim as a preferred claim and by its conduct lost its lien.

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* See copy in Appendix annexed.

C

The Tax Settlement Act of 1941 (Chapter 290), in Section 5, provides:

> "Discharge of Lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full."

Section 4 provides:

> "Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty."

Since the amount of the principal of the State's tax claims in default for the years 1932-1939 inclusive as shown in the Proof of Claim (R. 64) was $12,117 450.64, and the Trustee has paid the State $18,199,553 under court orders it would seem that all of the defaulted taxes with interest at 3% per annum has been paid in full.

However, if it should be determined that the compromise of the State's tax claims was not dispositive of the issues presented a resulting question which will have to be determined in the reorganization proceedings is the application of the payments aggregating $18,199,553 that have been made by the Trustee on account to the State. Another equally important question for determination will be whether under all of the facts and cir-

cumstances the State is entitled to interest at 3% per annum, from December 1, 1940, in accordance with the Tax Settlement Acts, or at 1% per month from the several dates of annual assessment as the State contends. If the interest is at 1% per month the State claims that there will be an additional amount payable to the State of approximately $15,000,000. If any such amount is determined to be payable to the State a very serious question of application of amounts already paid as between principal and interest will immediately arise because certain of the payments made were, by order of the Bankruptcy Court, specifically applicable to principal, whereas under the recent decision of Judge Oliphant in *State* v. *Erie Railroad Co.*, 23 Misc. Reps. 203 (June 11, 1945),

> "• • • every dollar of tax was intended to carry its own interest burden in the event that such dollar of tax should be in default.
>
> "To explain—let us suppose that $1,000,000 of taxes are in default and a railroad company wishes to pay $100,000 on account. At the time of the payment of the $100,000, the Comptroller must divide that sum into two component parts so that one of them will represent interest at the statutory rate on the other for the period of the delinquency. The interest component will then be deductible from the balance of interest owing at the time the payment is made and the principal component will be deductible from the balance of principal owing at that time. The mathematical formula for accomplishing this result is feasible and easy of application. Any payment heretofore made by the railroad companies subsequent to default must be so adjusted as to accomplish this result."

The mere statement of these questions that are involved in and raised by the Trustee's petition for adjudication of the State's claims emphasizes the error of the Circuit Court of Appeals in holding that the only matters

left open for the Bankruptcy Court to pass upon are (1) mathematical error in the computation of the amount of the tax, or (2) legal error in its assessment, and reversing Order No. 271, which confirmed the interim report of the Master which was to the effect that the Bankruptcy Court had jurisdiction to determine these questions.

It is the duty and within the exclusive jurisdiction of the Bankruptcy Court to inquire into the validity of claims, marshal them and control and enforce their liquidation and make application of the moneys already paid on the claim by the Trustees pursuant to court order.

Straton v. *New, supra;*
Isaacs v. *Hobbs Tie & Timber Co., supra.*

Order No. 333 (R. 296) under which the Trustee paid $15,250,000 in cash to the State on account of its tax claims contained this provision:

> "(a) in the event that the claims of the State of New Jersey shall be finally determined to be an amount greater than said payment, said payment shall be deemed to have been applied in satisfaction of said claims, as finally determined, for each of the years commencing with 1940 and extending back through each of the preceding years and portion thereof that said payment shall be sufficient therefor, provided that with respect to any year for which such payment shall be sufficient to satisfy only a portion of the claim the application shall be deemed to have been made ratably as between the principal amount of the tax and the interest thereon, at the rate finally determined, computed to the date of said payment; and provided further, that if it shall be finally determined that this Court may direct the application of said payment solely to the satisfaction of the principal amount of said claims, the application of said payment shall be deemed to have been made solely in satisfaction of said principal amount" (R. 297).

Paragraph 2 provided:

> "Except as otherwise provided in paragraph 1 of this order, the making of said payment by the Trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey" (R. 298).

For all of the above reasons the question as to what lien, if any, the State now has is wholly unsettled. This question is of paramount importance because, obviously, since the Debtor has outstanding an issue of $50,000,000. of General Mortgage Bonds on which interest has been unpaid since April 1939 and the amount and validity of this lien is unquestioned, the priority questions involved must be decided before any plan of reorganization can be devised.

CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed; and that the cause should be remanded with instructions to the District Court that it has exclusive jurisdiction to determine every question presented by the Trustee's petition for an adjudication regarding the State's claims.

November 6, 1946

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APPENDIX

Chapter 290, Laws of 1941 (N. J.)

AN ACT relating to the collection of certain delinquent taxes upon railroad companies.

WHEREAS, Certain taxes levied for the years 1932 through 1940 upon property used for railroad purposes in this State are delinquent and unpaid, and the total accumulated delinquencies, exclusive of interest penalties, amounted to more than thirty-four million dollars ($34,000,000.00) as of December thirty-first, one thousand nine hundred and forty; and

WHEREAS, Four of the railroad systems serving this State are or have recently been in reorganization under Federal bankruptcy laws, and there is serious doubt as to the ability of the railroads operating in the State to pay the delinquent taxes, and at the same time to continue to furnish adequate and safe service; and

WHEREAS, The limited area of New Jersey and its intensive industrial development make it peculiarly dependent upon efficient transportation, particularly because of the present demands of production for national defense, and immediate payment of accumulated tax delinquencies would impair the capacity of the delinquent railroads to furnish adequate and safe service; and

WHEREAS, The unpaid railroad taxes have tended to create a chaotic condition in State and municipal finances, and the entire State has an urgent and important interest in the immediate solution of the question of delinquent railroad taxes and in the maintenance of stable transportation facilities and public finances; now therefore,

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey*:

1. Installment payments. The State Treasurer is hereby authorized and required to accept, without interest penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and remain unpaid on the effective date of this act. But the State Treasurer shall not accept any installment payments under the terms of this act unless and until the delinquent taxpayer shall have complied with the requirements of sections seven and eight hereof.

2. Maximum period. The total principal amount of delinquent taxes payable under this act shall be paid in full, in accordance with the respecti capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, determined as the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be determined for each railroad system, and for each company not part of a system, by dividing its total amount of delinquent taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

For the purpose of this act, a railroad system shall be deemed to consist of an operating railroad reporting to

the Interstate Commerce Commission for the year one thousand nine hundred and forty and all the companies included in its report of system operations.

3. Date and amount. Installment payments shall be made on or before December first in each year. Each annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of delinquent taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under section two of this act.

4. Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty.

5. Discharge of lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full.

6. Liens preserved. The remedies of the State for the collection of delinquent taxes payable pursuant to the provisions of this act shall not be enforced against any taxpayer which enters upon the execution of an installment payment plan hereunder, in the manner provided by sec-

tion seven hereof, so long as installment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates. Upon default in payment of all or part of an installment payable in any year or of interest upon the unpaid balance, the whole remaining amount of delinquencies including interest penalties, shall, subject to the provisions of section five of this act, be reinstated and become due and payable thirty days after the date of default. Nothing in this section shall be construed to deprive any taxpayer of credit for installment payments upon the principal amount of delinquencies made prior to such default.

7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require.

9. Consents in reorganizations. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the act.

10. Construction. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under chapters nineteen to twenty-nine of Title 54 of the Revised Statutes; nor shall any provision of this act be construed to authorize or recognize any claim for any refund, return or credit of all or part of the taxes of any company heretofore paid for any year.

11. Distribution of receipts. The monies collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law. The State Treasurer shall credit receipts hereunder to delinquent accounts in the order in which the delinquent taxes were originally assessed.

12. Effect of unconstitutionality. If any provision of this act, or the application thereof to any person or circumstances, is held invalid, the remainder of this act, or application of such provision to other persons or circumstances, shall not be affected thereby.

13. Effective date. This act shall take effect immediately.

Approved July 22, 1941.

Chapter 241, Laws of 1942 (N. J.)

AN ACT to amend the title of "An Act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) so that the same shall read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years," and to amend the body of said act and to supplement said act.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. The title of "An act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) is amended to read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years."

2. Section one of the act of which this act is amendatory and supplementary is amended to read as follows:

1. Any railroad taxpayer desiring to accept the provisions of this act shall, on or before June fifteenth, one

thousand nine hundred and forty-two, file with the State Treasurer the acceptance document required by this act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this act and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, one thousand nine hundred and forty-one pursuant to the applicable tax acts, and of any assessment heretofore or hereafter made for the tax year one thousand nine hundred and forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this act.

3. Section two of the act of which this act is amendatory and supplementary, is amended to read as follows:

2. The total principal amount of unpaid taxes payable under this act shall be paid in full, and such payment may be made in installments as herein provided, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, which shall be the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be computed for each railroad system, and for each company not part of a system, by dividing its total amount of unpaid taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

4. Section three of the act of which this act is amendatory and supplementary is amended to read as follows:

3. The initial payment to be made under this act shall be made on or before June fifteenth, one thousand nine hundred and forty-two, and shall be an amount not less than the first annual installment computed as herein provided. After the payment of the initial installment on or before June fifteenth, one thousand nine hundred and forty-two, as required by this act, an additional installment payment shall be made on or before December first, one thousand nine hundred and forty-two, and in each year thereafter on or before December first of said year. Each such annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of unpaid taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under this act.

All such unpaid taxes shall bear interest at the rate of three per centum (3%) per annum, to be calculated from and after December first, one thousand nine hundred and forty. The initial payment shall include such interest to the date of such payment; and each subsequent payment

shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding installment payment. Any railroad taxpayer may, however, at the time or times herein specified for the payment of any installment of such taxes, pay the whole amount of taxes then remaining unpaid, together with the interest thereon as herein provided for, or it may at such time or times make payments in amounts in excess of the required installment payments, together with interest as provided in this act; or such taxpayer may make payment of any installment of taxes payable under this act in advance of the time or times specified by this act, together with the interest accrued to the date of such payment; and in any of such events, further interest shall cease with respect to the amount of the taxes so paid from the date of the payment thereof. Payments made by any railroad taxpayer shall be applied first to the payment of interest at three per centum (3%) per annum as provided by this act, and the amount of any payment in excess thereof shall be applied to the unpaid taxes owing by such taxpayer, in the order in which such taxes became payable under the applicable tax acts.

Should any railroad taxpayer so direct in the acceptance document filed pursuant to this act, the State Treasurer is hereby authorized and required to collect the amount of any drafts or checks, heretofore delivered to him by such railroad taxpayer in attempted compliance with the provisions of pamphlet laws of one thousand nine hundred and forty-one, chapter two hundred ninety, and to credit the same to the payments required to be made by such taxpayer under this act. If the amount of any such draft or check is less than the amount of taxes and interest required to be included in the initial payment, such taxpayer at the time of filing its acceptance document shall pay the balance of the initial payment required by this act.

5. Section four of the act of which this act is amendatory and supplementary is amended to read as follows:

4. Upon the acceptance of the provisions of this act by any railroad taxpayer, and as long thereafter as such railroad taxpayer shall make payment of the unpaid taxes and interest required by this act, there is and shall be stayed and suspended any remedy or proceedings to collect any unpaid taxes for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and any statutory interest penalties with respect to any taxes assessed for said years.

6. Section five of the act of which this act is amendatory and supplementary is amended to read as follows:

5. Whenever any railroad taxpayer accepting the provisions of this act heretofore has paid, or hereafter shall have paid, as required by this act, the full amount of all taxes assessed upon its property used for railroad purposes for the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and all interest, if any, required by this act, such taxpayer and its property shall be released and discharged from any and all claims for statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any and all of the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

7. Section six of the act of which this act is amendatory and supplementary is amended to read as follows:

6. Upon default in the making of any payment provided for in the acceptance document, and a continuance thereof for a period of thirty days after the due date of

such payment, the then remaining unpaid balance of taxes, together with statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, calculated from the original due date of such taxes shall immediately become due and payable, and the State may assert, exercise and enforce any and all rights, claims, demands, liens and privileges with respect thereto as if this act had not been enacted, and in addition thereto may assert and enforce any remedies it may have acquired under such acceptance document except that such taxpayer shall be entitled to a credit against such statutory interest penalties in an amount equal to the interest paid pursuant to the provisions of this act.

8. Section seven of the act of which this act is amendatory and supplementary is amended to read as follows:

7. The acceptance document herein referred to shall be in substantially the following form:

ACCEPTANCE AND WAIVER

The (insert name of railroad or system) does hereby accept the provisions of (insert the amended title of this act), and hereby undertakes and agrees to pay to the State of New Jersey in the manner and at the times prescribed by said act the sum of (insert total amount of taxes unpaid on December 1, 1940), being the total principal amount of taxes remaining unpaid on December 1, 1940, which were theretofore assessed against or levied upon the property used for railroad purposes for the years 1932 to 1940, inclusive, of the (insert name of railroad or system) together with interest thereon, to be computed at the rate of three per centum (3%) per annum from and after December 1, 1940.

(If any railroad taxpayer has heretofore delivered or tendered a draft or check to the State Treasurer on account of any part of such taxes or interest in attempted compliance with the provisions of P. L. 1941, chapter 290, the following clause may be added) "and said (insert name of railroad or system) does hereby authorize and direct the State Treasurer of New Jersey to retain and accept the draft or check heretofore delivered to him on the ..... day of ....., 1941, in the amount of ..... dollars, and to collect and credit the same upon the initial payment required to be made by this act."

And said (insert name of railroad or system) for itself and the following companies whose railroads are included in its system, to wit (list of companies) does hereby waive any and all rights under the laws of the State of New Jersey and of the United States to contest the legality or amount of any assessment upon its or their property used for railroad purposes made prior to December 1, 1941, pursuant to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year 1941.

In Witness Whereof said (insert name of railroad or system) has caused this instrument to be sealed with its corporate seal and attested by its officers thereunto duly authorized, this ..... day of ....., 1942.

(Seal)

(Signatures)

9. Section eight of the act of which this act is amendatory and supplementary is amended to read as follows:

8. The consent to the discontinuance and dismissal of pending appeals and litigation shall be in substantially the following form:

Appendix

DISCONTINUANCE AND DISMISSAL

(Name of Court or tribunal)

(Names of parties to proceeding)

In re Assessments for (insert tax year)

On motion of (insert name of taxpayer or appellant) it is on this day of , 1942

Ordered that the appeal (or other proceeding) with respect to the taxes and assessments of the property of (insert name of taxpayer or appellant) used for railroad purposes for the tax year be and the same is hereby discontinued and dismissed.

We consent to the foregoing order.

(Signature of attorney for taxpayer or appellant)

10. Section nine of the act of which this act is amendatory and supplementary is amended to read as follows:

9. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act.

11. Section ten of the act of which this act is amendatory and supplementary is amended to read as follows:

10. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under the applicable tax acts; nor shall any provi-

sion of this act be construed to authorize or recognize any claim for any refund, return or rebate of any part of any taxes of any company heretofore paid for any year by any railroad or system.

12. Section eleven of the act of which this act is amendatory and supplementary is amended to read as follows:

11. The moneys collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law.

13. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

14. As used in this act:

(a) The phrase "tax years involved" is defined to mean any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, both inclusive.

(b) The phrase "applicable tax acts" is defined to mean all statutes providing for the assessment and collection of taxes on property used for railroad purposes in effect for any or all of the tax years involved.

(c) The phrase "railroad taxpayer" is defined to mean any railroad system or railroad not part of a system owning or operating a railroad in this State, or the duly appointed and qualified receiver, receivers, trustee or trustees thereof, whose property used for railroad purposes has been assessed for taxes for any of the tax years involved, pursuant to the applicable tax acts as herein defined.

(d) The phrase "statutory interest penalty" is defined to mean the one per centum (1%) per month charges provided by the applicable tax acts or by any other act to be collected in the event of the failure to pay the taxes assessed under the applicable tax acts at the times specified therein.

(e) The word "interest" is defined to mean the interest at three per centum (3%) per annum provided to be paid by this act.

(f) The phrase "acceptance document" is defined to mean the instrument referred to in section seven of this act.

(g) The phrase "railroad system" is defined to mean an operating railroad company reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all companies included in its report of system operations.

14. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

15. The purpose and object of this act is to provide for the payment by railroad taxpayers of unpaid balances of taxes assessed for the tax years involved, pursuant to applicable tax acts, upon property used for railroad purposes in this State, and to that end, it is hereby determined and declared:

Beginning with the year one thousand nine hundred and thirty-two and continuously thereafter, this State, at great expense and with considerable interruption to the orderly disposition of other tax review proceedings by State tribunals, has been engaged in litigation concerning

the validity and amount of assessments upon property used for railroad purposes in this State; and litigation involving substantial amounts of taxes and debatable questions of law and fact relating thereto are still pending and undetermined for certain of the tax years involved.

The development of competitive transportation facilities, the more general use of fuels other than coal, the shrinkage of export rail traffic destined to the Port of New York, the decentralization of industry and other causes, as well as the economic depression of the past decade, adversely affected the financial position and progress of the railroads operating in New Jersey, and although the income of such railroads was substantially decreased from former levels, the tax obligations of such railroads were not materially reduced.

The statutory interest penalty provisions of the applicable tax acts have not proven effectual to accomplish their purpose of assuring prompt payment of taxes, and unpaid balances of taxes for the tax years involved now exceed in the aggregate thirty-four million dollars ($34,000,000.00), exclusive of any claims of the State for statutory interest penalties relating to taxes assessed for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

The prosecution of statutory legal proceedings under the applicable tax acts to enforce collection of unpaid balances of taxes and statutory interest penalties for the tax years involved has been accompanied by the institution and prosecution by certain railroad taxpayers of appropriate proceedings under Federal bankruptcy laws, resulting in the appointment of receivers or trustees of certain of such railroad taxpayers and their properties. Several railroad taxpayers of this State, whose taxes are in part unpaid, are now involved in such proceedings. It is probable that similar proceedings may be undertaken

with respect to other railroad taxpayers and their properties if existing statutory collection proceedings are continued or new proceedings instituted.

Whatever claims for unpaid taxes and statutory interest penalties have been filed on behalf of the State in such bankruptcy proceedings, the provability of the amount of the claims of the State has been questioned and objections have been filed by the receivers or trustees in reorganization to the allowance thereof. Litigation arising in connection therewith is pending in various Federal courts in which the bankruptcy proceedings are pending.

The delay and uncertainty in the collection of the unpaid balances of railroad taxes has created a chaotic condition in State and municipal finances and such tax moneys are urgently needed to pay existing and potential costs of government. It is imperative that a substitute and more effective and feasible method for the collection of such unpaid balances of taxes be provided promptly.

To meet the existing national emergency and aid the effective movement of armed forces and supplies, so that this State and the nation may be protected, it is essential that the railroads in this State be not financially harassed by the continued attempt to collect statutory interest penalties with respect to the taxes assessed for the tax years involved.

For more than fifty years last past, it has been the well recognized and approved public policy and practice of this State and its various agencies and subdivisions to meet financial emergencies resulting from long periods of financial depression by compromising, adjusting, abating and altering the amount and method of payment of obligations of taxpayers.

This Legislature has given consideration to investigations, recommendations, hearings and reports made by various public officials, legislative and other committees,

both during the current legislative year and prior thereto, in the matter of taxes assessed on property used for railroad purposes, and has particularly given consideration to a report on the subject made by the Joint Legislative Committee constituted by Senate Concurrent Resolution No. 8 of the one thousand nine hundred and forty-one Legislature, and a report dated February twenty-second, one thousand nine hundred and forty-one, made by a citizens committee appointed by His Excellency, Charles Edison, Governor of this State.

Certain railroad taxpayers have heretofore attempted to accept the provisions of this act as originally enacted, and as a result thereof, the State Treasurer now has in his possession drafts and checks in an amount in excess of ten million dollars ($10,000,000.00). Questions having arisen respecting the validity and construction of this act as originally enacted, such funds may not be presently available for use by either the State or its various agencies and municipalities. Should changes in financial status result in such drafts or checks becoming uncollectible, or should some or all of such railroad taxpayers undertake to withdraw such drafts or checks and all instruments filed in attempted compliance with said act, serious legal and financial questions may arise as to the rights of the State.

This Legislature has also considered the report made to it by its committee appointed pursuant to Senate Concurrent Resolution No. 2 of the one thousand nine hundred and forty-two Legislature.

After due deliberation and consideration, it is determined and concluded that the existing claims, controversies and litigation above mentioned can best be disposed of, and that the unpaid balances of taxes assessed upon property used for railroad purposes for the tax years involved can best and most quickly be collected, in the

manner and upon the terms and conditions herein provided, and that upon the acceptance of, and compliance with, such terms and conditions by any railroad taxpayer the State will have received full, fair and adequate consideration, and the best interests of the State will have been served and furthered.

15. If any provision of this act or the application thereof to any person or circumstances is held invalid, the remainder of this act, or the application thereof to other persons or circumstances, shall not be affected thereby.

16. This act shall take effect immediately.

Approved May 21, 1942.

Excerpts from Chapter 291, Laws of 1941 (N. J.) (New Tax Act)

CHAPTER 291

AN ACT relating to taxation of railroads, and repealing chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, chapter ninety-one of the laws of one thousand eight hundred and eighty-five, chapter two hundred seventy-five of the laws of one thousand eight hundred and eighty-six, chapter three hundred thirty-three of the laws of one thousand nine hundred and twenty-one, and chapter four hundred twenty-three of the laws of one thousand nine hundred and thirty-three.

ARTICLE II

7. Property taxable; rate. There is hereby levied an annual property tax upon all property used for railroad

purposes at the rate of three per centum (3%) upon the true value thereof. The tax hereby imposed shall be assessed by the State Tax Commissioner, in the manner hereinafter provided, for the year one thousand nine hundred and forty-one and for each year thereafter.

• • •

13. Franchise excise. An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided. This tax shall be in lieu of any other tax or taxes of or upon such franchises.

ARTICLE VIII

54. Lien of taxes. The taxes imposed by this act or heretofore imposed pursuant to any act for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the first day of the year in which the tax is payable. L. 1941, c. 291, p. 791, §54.

• • •

ARTICLE X

74. Construction; other taxes. All other State and local taxes of or upon franchises or property used for railroad purposes, which may have been assessed for the first year in which this act becomes effective upon any taxpayer subject to taxation hereunder prior to the enactment of this act, shall abate and be cancelled of record as of the effective date hereof. This act shall be con-

strued as a revision of chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, and nothing herein shall be construed to affect any pending litigation, nor to repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed to any taxpayer, or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act, or under any other law, except as specifically provided in this act. Nor shall this act affect in any manner any distribution, allotment or apportionment of tax receipts made or required to be made under any provision of law repealed by this act.

75. Repealers. Chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes are hereby repealed.

Chapter 91, of the laws of 1885;
Chapter 275, of the laws of 1886;
Chapter 333, of the laws of 1921; and
Chapter 423, of the laws of 1933;

are hereby repealed.

Excerpt from Tax Act of 1888 as Amended

54:27-4. *Default; penalty; remedies; lien.*

If the taxes of any company, or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a

writ of certiorari or other remedy. These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this state. The lien shall take effect on June first of the year in which the tax is payable and shall be a debt due from the company to the state on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in chapters 19 to 29 of this title (§54:19-1 et seq., Ch. 208, P. L. 1888 as amended by Ch. 138, P. L. 1921, Sec. 2).

Section 57 of the Bankruptcy Act (11 U. S. C. A. 93)

Sec. 93. *Proof and allowance of claims.*

* * *

(c) Proofs of claim may, for the purpose of allowance, be filed by the claimants in the court of bankruptcy where the proceedings are pending or before the referee if the case has been referred.

(d) Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest or unless their consideration be continued for cause by the court upon its own motion: *Provided, however,* That an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceedings under this title.

* * *

(f) Objections to claims shall be heard and determined as soon as the convenience of the court and the best interests of the estates and the claimants will permit.

* * *

(h) The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court.

* * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

(n) Except as otherwise provided in this title, all claims provable under this title, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: *Provided further,* That,

except in proceedings under chapters 10, 11, 12, and 13 of this title, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer: *And provided further*, That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case. July 1, 1898, c. 541, sec. 57, 30 Stat. 560; Feb. 5, 1903, c. 487, sec. 12, 32 Stat. 799; May 27, 1926, c. 406, sec. 13, 44 Stat. 666; June 22, 1938, c. 575, sec. 1, 52 Stat. 866.

Section 64(a) of the Bankruptcy Act (11 U. S. C. A. 104(a))

Sec. 104. *Debts which have priority.*

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the

filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this title, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate

therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Section 65(a) of the Bankruptcy Act (11 U. S. C. A. 105(a))

Sec. 105. *Declaration and payments of dividends.*

a. Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured.

Section 67(b) (c) and (f) of the Bankruptcy Act (11 U. S. C. A. 107(b) (c) and (f))

Sec. 107. *Liens and fraudulent transfers.*

* * *

b. The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or

of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter 10, 11, 12, or 13 of this title, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 104 of this title, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 104 of this title.

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f. (1) For the purposes of, and exclusively applicable to, this subdivision f (a) "debtor" shall mean a face-amount certificate company as defined in section 80a-4 of Title 15; (b) "face-amount certificate" shall mean a face-amount certificate as defined in section 80a-2 of Title 15; (c) "depositary" is a person or State agency with whom securities or other property of a debtor is deposited or to

whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor or under other specified circumstances; (d) "deposit creditor" is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) "State agency" is an official or agency of a State designated to act as depositary or to distribute property, or the proceeds of property held by a depositary.

(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor, and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision f.

(3) In the event any deposit or transfer described in paragraph 2 of this subdivision f shall be avoided the trustee shall segregate the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or

agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to dividends from the estate only after all creditors of the same rank shall have received the same percentage.

(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply. As amended June 2, 1938, c. 575, sec. 1, 52 Stat. 875; Aug. 22, 1940, c. 686, Title 1, sec. 29 (a), 54 Stat. 835.

Pertinent Provisions of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205)

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property

by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, the amendment of the charter of the debtor, and/or the issuance of securities of either the debtor or any such other corporation or corporations for cash, or in exchange for existing securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted. The term "securities" shall include evidences of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and warrants to receive, or to subscribe for, securities. The term "stockholders" shall include the holders of voting-trust certificates. The term "creditors" shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise con-

stitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

The term "claims" includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors. In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. The provisions of section 96 of this title shall apply to a proceeding under this section. For all purposes of this section any creditor or stockholder may act in person or by an attorney at law or by a duly authorized agent or committee subject to the provisions of subsection (p) of this section. The running of all statutes of limitation shall be suspended during the pendency of a proceeding under this section.

(c) After approving the petition:

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(7) The judge shall promptly determine and fix a reasonable time within which the claims of creditors may

be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests. The trustee or trustees under any mortgage, deed of trust, or indenture outstanding against the property may, within the time prescribed, file a verified claim in behalf of all bonds or securities outstanding under such mortgage, deed of trust, or indenture, in which event it shall be unnecessary for the holders of such bonds or securities to file claims in their own behalf, but nothing herein shall constitute such trustee or trustees the representative or representatives of such holders for the purpose of accepting or rejecting any plan of reorganization.

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(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, including those who have not, as well as those who have, accepted it, and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it. Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative

thereto, under and subject to the supervision and control of the judge, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Upon confirmation of a plan the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended. The provisions of sections 77a to 77aa of Title 15 shall not apply to the issuance, sale, or exchange of any of the following securities, which securities and transactions therein shall, for the purposes of said sections, be treated as if they were specifically mentioned in sections 77c and 77d of Title 15, respectively: (1) All

securities issued pursuant to any plan of reorganization confirmed by the judge in accordance with the provisions of this section; (2) all securities issued pursuant to such plan for the purpose of raising money for working capital and other purposes of such plan; (3) all securities issued by the debtor or by the trustee or trustees pursuant to subsection (c), clause (3) of this section; (4) all certificates of deposit representing securities of, or claims against, the debtor, with the exception of such certificates of deposit as are issued by committees not subject to subsection (p) of this section. The provisions of subdivision (a) of section 78n of Title 15 shall not be applicable with respect to any action or matter which is within the provisions of subsection (p) of this section.